UNIT 1 NATURE AND DIMENSIONS OF BUSINESS ENVIRONMENT

Structure

1.0 OBJECTIVES

After studying this unit, you should be able to:

- describe the nature and meaning of business environment
- explain the significance of business environment in the realm of managing business
- acquire the knowledge of various components like economic, political and legal dimensions of business environment
- analyse the implications and impact of business environment at various geographical levels
- provide an insight into how the environment affects the managerial dimensions of business.

1.1 INTRODUCTION

Any activity which has the objective of earning profit is called business. Such activities are termed as economic activities. They may take the form of consumption, production, distribution or exchange. The basic function of business is to optimize the outcome of the economic activities. This is the concept at the macro level. When we consider the issue from micro view point, we find that a business firm is an economic unit, Its primary function is to transform a set of inputs into output which includes both goods as well as services. The objective of a firm carrying on business is the same i.e. to earn profit. The firm, therefore, has to plan very carefully the allocation of resources so as to get the optimum results. The entire process of creation, mobilisation of resources, and utilisation of surplus constitutes the business activity.

In performing such economic activities various decisions have to be taken. Decision making involves a choice of the best alternative from among various alternatives. The choice is made and affected by various variables, Some of the variables are controllable

and others uncontrollable. Controllable variables are those which are within the control of the individual business firms. Uncontrollable variables are those which are external to the business firms. Such uncontrollable factors are termed as environmental factors because they constitute part of the environment. The environment may be economic, social, political and legal. Each of these constituents may also be domestic or international. Thus the business policy, business strategy and also their implementation depends on the environmental variables.

1.2 MEANING AND SIGNIFICANCE OF BUSINESS ENVIRONMENT

The business environment provides the macro-economic context within which a business firm which is a micro-economic unit operates, The term 'environment' refers to a set of external factors and forces which are outside the control of the firm. A firm individually cannot influence the external environment.

It is difficult to classify the external variables because all the variables are interdependent and mutually exclusive . Based on the relevance of these **economic** or **non-economic** factors, we may specify economic and non-economic environment of business. Economic variables are economic in nature and are directly related with various economic issues like income, financial,policy, fiscal measures, etc. Non-economic environment serves those .factors which are non-economic in nature but have bearing on the economy of the business. Culture, traditions, history, political, sociological, and other dimensions would be the examples of non-economic factors.

Since the economic and non-economic factors have mixed response, sometimes both these are mixed together. For example, we call socio-economic factors where effect of social conditions on the economy and the impact of economic factors on the society are analysed. Similarly, when we talk of politico-economic environment we scan both political situation and the economic issues with a view to get clarity as to how the political conditions affect the economic scenario and how the economic changes bring out political revolution. For example, the basic objective of business is to earn and maximize profits. The social and political revolution terms profit maximisation as a social sin and businessmen who aim at earning maximum profits are branded as profiteers. But profit earning is the very essence of business. The businessman therefore has to respond to the requirements of social factors. Thus he does not talk in terms of maximisation of profit, instead he talks about optimisation of satisfaction. The word optimisation is viewed not as maximising any thing but bringing about equilibrium between the two parties i.e. business and the society. The businessmen get satisfaction by' earning profit and the society gets satisfaction when social norms are achieved by the business through its various activities. The balance between these two will bring the optimum level. Thus business firm While planning its operations will have to screen the social environment and will have to operate within and as per the norms of the society. This explains the relevance and significance of business environment.

The business environment is highly dynamic and has several dimensions. It may be classified on different criteria. These are: time, space, forces and factors. In terms of 'time', we may talk of past, present and future environment. When we talk of 'space', the business environment can he local, regional, national or international, Similarly, based .on 'forces' the environment depends on market forces, political events and happenings and social ups and downs. Because of such forces it becomes very difficult to identify, describe or explain either the present or future environment, Element of uncertainty is so deep rooted that precise prediction and estimation of environmental variables becomes a herculean task. But the business and more particularly manager can not adopt or adapt unless he forecasts the likely changes in the immediate future in terms of both magnitude and direction. Thus forecasting brings in the uncetainty element thereby exposing to risks. For meaningful exercise the environmental factors are scanned and the focus is limited to important ones. Finally based on the 'factors', we may specify economic and non-economic environment of business. The economic and lion-economic variables are not visible separately. They are so closely related, interact with each other and the task of identification appears to he niore complex. Therefore the proper understanding of the

environmental factors becomes highly crucial for the husiness.

Check Your Progress A

1. What is "Business Environment"?

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2. Give the definition of politico-economic environment.

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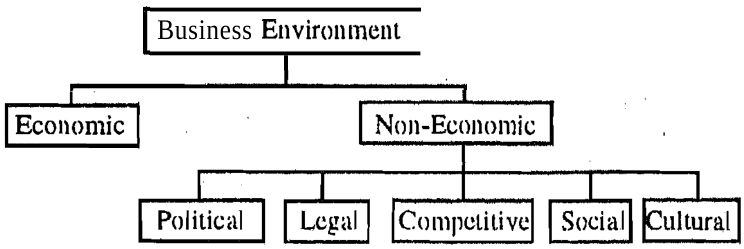
1.3 COMPONENTS OF BUSINESS ENVIRONMENT

Business environment broadly consists of internal as well as external environment. When we talk of the internal environment we mean those factors which are within the control of the firm and such factors are concerned with firm's resources. policies and objectives. But hy and large whenever husiness environment is talked it is taken to he in the sense of external environment i.e. those variables which are independent of the firm and therefore uncontrollable. The components of external environment can he depicted in the following diagram:



1.3.1 Economic Environment of Business

Economic environment consists of three elements: 1) Economic conditions; 2) Economic policy, and 3) The economic system. By economic conditions wc mean the nature of the economy, economic resources, the level ot' income, the distribution of income and wealth and the stages of development of the economy. All these factors have a direct hearing on the strategies to he adopted hy a business firm. In terms of nature of the economy there could he free market economy or capitalist economy where the economy remains in the hands of private sector. At the other extreme thcrc may be centrally planned economy which is also called as the communist economy. Here the entire economy remains in the hands of the state. In between these comes mixed economy where both private and public sectors co-exist. However, in mixed economies there may be wide variation. In some cases private sectors may occupy more significant place while in sonic situations puhlic sector may have the upper hand.

In a lice market economy private enterprise has the maximum freedom, and (i) the factors of production (land, labour, and capital) are owned hy the private enterprise and the initiative for production comes from the private businessmen, (ii) the economy is guided by profit consideration and income is derived from the production and sale of goods and services in the open market without any restriction or regulation hy the society or state,(iii) there is complete freedom of choice in matters of production, consumption, savings, investment, and even occupation, (iv) there is no interference, regulation or control by the government. Such a type of economy does not exist in reality. Even tlie so called free economies like USA and Great Britain do not have complete freedom. Even in these countries government regulations are there to regulate the economy.

Under communist form of economy all the factors of production and distribution are owned and controlled by the state. There is hardly any private entrepreneurship. Even the consumption pattern is determined and implemented by the state. The Soviet Union, China, Hungary, Poland were the examples of this type of economy which is also called as centrally planned economy.

In between the two extremes, comes the mixed economy. Here both public as well as private sectors exist. But the extent of the mixture differs widely. The basic fact remains that the state regulates the overall structure of economy. Within the control and regulation exercised by the government private enterprise functions, India is an example of mixed economy. After independence predominant role of government was accepted. But gradually the private sector started assuming vital role. With the initiation of New Economic Policy in 1991 the concept of privatisation and liberalisation has been given more prominent role.

What economic system will exist in a particular country is determined by the people and the government. The firm has no control aver it. However, the firm's policies and practices depend upon the type of economy in vogue. Thus the economic environment is a very important external factor on which the working of business firms depends. Management cannot overlook the market oriented or non-market oriented nature of environment, The management has to keep in view the objectives of national planning or the economic policies of the government. In other words while planning its operation the firm has to keep in view the pattern, structure and even the rate of changes occuring on the economic scenario.

1.3.2 Non-Economic Environment of Business

The country's history, culture, sociology, political system and legal structure are the elements of non-economic environment. Non-economic environment variables have also very important economic implications and they affect the business in multi-dimensional ways. For example, the ideology of the government in power exercises very significant impact on tax laws, distribution mechanism, existence and development of big companies, and so on. As a matter of fact non-economic factors and economic factors are interdependent. Sometimes these factors are grouped together and referred to as socio-economic or politico-economic factors. We now discuss the various non-economic factors in detail.

Sociological Factor$

Sociological factors are the important part of non-economic variables. By this, it is meant the attitude of the society towards managers, authority, responsibility, delegation, workers' participation, achievement, wealth, income, status and spending. Whether the customs of the society are rigid or flexible? The attitude towards scientific methodology, and religion is also important. Class structure, labour mobility, and caste system are also important aspects. Attitude towards education and acquisition of knowledge, vocational and technical training and other similar factors also exercise strong influence on business activities. Thus the sociological variables could be either socio-cultural or socio-educational. In addition the buying and consumption habits, spending habits of the people, their beliefs and values could also be significant in business planning.

For a business to be effective and successful it is necessary that its' strategy is in accordance with the socio-educational-cum-cultural environmental variables. The marketing mix will also be such as to suit the environmental characteristics of the market which in turn depends on sociological factors. Social inertia sometimes come in the way of promotion of certain products. For example, in marketing of family planning ideas or the use of bio-gas for cooking are affected by social stigmas. In such cases the marketing personnel will have to apply dual approach. On the one hand, it will have to adopt strategy to be in tune with social stigmas and in the long run it may take concrete steps even to change the value system,

Consumerism is also a very important social movement. It exercises a considerable influence on the socio-economic environment'of business, It aims 'at augmenting the rights and powers of the consumer in relation to sellers. The state at which the consumers movement prevails affects the marketing policies of the firm. The concept of consumer

welfare will lay emphasis on social and ecological considerations in the product and market planning. The social responsibility of the business is an added dimension of social environment. More educated the society becomes more social responsibility falls on the business.

Political and Legal Environment

Political and legal factors are very closely related. Legal enactments depends on the political climate. These include: (i) Ideology of the political organization ruling the country (ii) Role and attitude of bureaucracy (iii) Political stability or instability (iv) Legal rules and enactments (v) Flexibility of constitutional amendments (vi) Foreign policy and relations (vii) Image of the country (viii) The attitude of legal machinery, etc.

In India most of the statutory controls have very comprehensive and pervasive influence on the various aspects of the business concerning location, licensing, pricing, expansion, distribution and labour relation. Therefore the chief executive and the managerial personnel have to devote a considerable attention to ensure the observance of various legal enactments.

Competitive Environment

Competition is another external variable which affects the business strategy of a firm. However, there are three different types of competition- perfect competition, monopolistic competition, and oligopoly. Each of these have their own characteristics. Under perfect competition there are more number of firms and hence the market power of a single firm is of no use. But under monopoly since there is no competition a firm would enjoy enormous power. Under oligopolistic market number of firms remains limited hence there is the possibility that firms may take joint decisions concerning price, output, etc. This provides them monopolistic power. Thus the power which a firm can enjoy would depend on the type of competition prevalent in the market. However, it has to he noted that in several countries there are laws to regulate competition. The objectives behind such regulation are: elimination of competition and dilution of monopoly power. In India we have Monopolies and Restrictive Trade Practices (MRTP) Act which has the objective of controlling monopolistic undertakings and preventing the concentration of economic power in few hands. Laws enacted with a view to regulate competition in the public interest have significant impact on the competitive environment.

Demographic Environment

By demographic environment we mean the size and growth rate of the population. It also includes sex, composition, family size, religion, etc. All these factors have direct bearing on the demand. When, the population is increasing it results in increase in labour supply, It also brings about a steady rise in demand. When labour supply increases with the growth of population labour intensive techniques of production get encouraged. On the contrary, labour shortage results in the adoption of lahour-saving technologies, Another implication of demographic environment could he explained in the growth of multinationals in developing countries. Cheap labour and a growing market are the two mast important features which have motivated multinationals to invest more 'and more in such countries.

Physical and Technological Environment

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Physical, geographical and technological factors also play a very significant role in the realm of non-economic environment. Physical factors (geographical factors) very often call for modification in the product mix so that the product mix may suit the environment. Availability of physical facilities also affect the business prospects. For example, the demand for home appliances and other electrical goods is affected by the extent and magnitude of electrification and supply of power. Similarly, the rate of growth in LPG connections will affect the demand for stoves.

Technological factors bring about rapid economic growth, hut sometimes at social costs, Different technological environment affect the designing of the products. For example, in USA and several other countries electrical appliances and instruments are designed for 110 volts. But when they are sold in India they are made of 220 volts. Similarly, technological developments mag create demand for sevwal new products. For example in

India there is too much and too frequent voltage fluctuation,therefore the market for stabilizers is quite rosy. But this is not the situation in other countries.

Technological ,developments thus, bring about rapid economic development, but at a huge social cost in terms. of pollution 'and other areas. Biologists, ecologists and sociologists are therefore concerned about social costs. Much is being talked about the social responsibilities of business. The business has to develop awareness about social cost-benefit analysis with a view to cope with the fast changing technological environment.

1.3.3 Interaction between Economic and Non-Economic Environment

So far we have discussed factors constituting economic and non-economic environment which exercise a strong influence on business activities. Now let us consider the interaction between economic and non-economic environment. Economic and non-economic environment can neither be separated nor identified exclusively. Both interact with each other. This is so because their treatment in isolation is neither feasible nor of any significance. The economic environment is said to be both exogenous as well as endogenous. It determines the non-ecunomic environment and at the same time it is determined by non-economic environment. The economic condition is affected by sociological factors and similarly social norms and values are shaped by the income of the people, Thus individually each critical element of economic environment interacts with each critical element of non-economic environment.

Since business environment is dynamic and uncontrollable, the business policies and strategies have also to be dynamic and subject to review periodically. The success of any business would depend on the ability of the business to foresee the nature, extent, and dimensions of'changes likely to occur in both-economic and non-economic environment. Further the extent to which the business adopts itself to the likely changes by altering its strategies would determine the probability of its success.

1.4 BUSINESS ENVIRONMENT AT VARIOUS LEVEES

We have defined business environment as a set of external factors and forces which are outside the control of a firm, We have also explained the different compopents of business environment, viz., political, legal, competitive, social, cultural and economic. The various components keep on changing; they differ from place to place and time to time. Obviously, the environment that obtained in the past would have been different than the one that obtains in the present; one can only expect a different business environment in future. Economic conditions, economic policies and even the systems keep on changing in response to changes in the economic situation of the community and the country. Likewise, the political, legal, competitive, social and cultural milieu also undergoes a change when one moves along the time frame.

The movement of time is obvious, and hence it is also apparent that the conditions, in which a business firm works would be different along different time frames.

Equally important are the changes in business environment at different dpaces. A business firm is pot, and cannot be, point-centric. A business firm operating, say from Tamil Nadu or Andhra Pradesh, cannot afford to concentrate all of its energies on analysing the business conditions as they obtain in Chennai or Hyderabad. Equally important for the firm is to keep a watch on the events and developments not only in other parts of the state but also' in the rest of the country, as also internationally.

In short, a business firm does not close itself to events and situations occuring elsewhere. The space, in which a business firm operates can be classified in three distinct categories, i.e. 1) Regional, 2) National, and 3) International.

1.4.1 Regional Level

Environmental analysis at the regional level will require an analysis of the different conditions that obtain in the region of operation of a business firm. Of course, if. a business firm is planning and contemplating to expand its business operations to new regions, it shall have to scan the environmental conditions there also.

Environmental analysis at the regional level, once again, would rely on different

components of business environment as explained in section 1.3. However, what is important here is that the analysis would be a region-specific. For example, if a business firm has its area of interest limited to North India; it would have to equip itself well with the necessary information relating to the social and cultural habits of the North Indians, their living styles, their spending habits, the festivals and the customs, the income levels, the political activities, the local laws, etc. Now this milieu may be entirely different than the one that obtains say in East, West or South India. Any business practice that may be found useful in a specific region may be found wanting in other regions. The social political, cultural and economic milieu is specific to a given region, and hence it need be analysed accordingly.

1.4.2 National Level

A nation is a bigger entity than region. As a matter of fact a nation is an aggregate sum of individual disparate regions. Environmental analysis at the national level looks at the disparities between different regions, and makes out a common view about the whole. Individual trees do not count; it is the whole forest that is looked at and scanned,

Of course, when we are looking at the national environment the broad components that we need to analyse remain the same as above. But here, for the obvious reasons, our perception will change. We are no more interested in local-level political changes, or local-level diversities in income levels and spending habits. Our outlook is much broader. Our perceptions are much wider, these encompass whole of the nation as one unit.

1.4.3 International Level

Business is influenced as much by events and conditions that obtain domestically as by what happens in the rest-of-the-world. With the information-technology revolution underway and whole of the world gradually shrinking to become a global village, any event or a change, howsoever small, leaves its impact world-wide. For example Delhi stock exchange may be affected as much by poor corporate results of domestic companies as by a political showdown in Tokyo or New York. No business can remain immune to events elsewhere in the globe.

To prepare itself for any challenge or opportunity, a business firm has to undertake international environmental analysis. International environmental analysis, again, would rely on the same economic and non-economic components. One has to look at all these components from a global perspective and not from a region's or a nation's perspective. Just as the national analysis differs from the regional analysis, international environmental scanning would take a more broader view than the national analysis.

Check Your Progress B

1. What are the critical elements of economic environment?

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2. List the various factors of non-economic environment.

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3. What do you understand by the interaction between economic and non-economic environment.

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1.5 BUSINESS AND ENVIRONMENT INTERFACE

Business environment influences business and elements of business. When there is business recession the production is curtailed. When the market is faced with competition either directly or through substitutes, aggressive advertisement and promotion may be resorted. When the interference from the financial institutions starts coming either in the form of credit squeeze or increase in the interest rate, business will have to depend on its internal funds rather than on debt capital. When minimum wage legislations are passed or when the government provides for social security measures for permanent employees, the business may start thinking in terms of casual workers. These examples show that whenever shocks are generated by the Government, absorbers are arranged by the business. As a matter of fact the environment act either as a stimulant or as a constraint. When the environment is favourable and conducive for business prosperity and growth the business have to respond positively and formulate strategy accordingly. For instance, when subsidy is announced for small business, they feel encouraged. Similarly when high rate of taxation is imposed on corporate profits, small business gets boost. Therefore the business environment changes may act as stimulant to one group and and as constraint to the other group.

There are indirect interactions also. Sometimes the business has to take measures not only to protect its own interest but also the interests of other parties. The interface of the business and business environment is at two levels. One at the level of business environment interest and the other between the two.

Thinking in terms of interface we find that business environment has two broad divisions-economic and non-economic. The economic environment affects the non-economic environment and non-economic environment affects the economic environment. For example the politico-legal environment and the economic environment of business are interdependent. When there is political stability business grows as businessmen venture to take more and more risks. But under conditions of political instability business. uncertainties prevail and businessmen do not come forward to undertake risks. In the same way ideologies of the ruling party and the business are interlocked. When socialist ideology prevails which emphasises on nationalisation, the private business gets discouraged. On the contrary, sometimes various legislations are enacted to deal with the prevailing environment. For example during industrial recession or when the private business ignores its social responsibility the government through legislation comes forward to streamline the functioning of business. This has been done in India by passing Consumer Protection Act, MRTP Act, etc.

The educational-cultural environment and the economic environment of business are also linked. The stage of economic development affects the educational system. When tbe economy is developed costly higher education will be available. Similarly lack of vocational training or professional courses will lead to unemployment problem and affect the economy adversely.

The sociological environment also affects and gets affected by the economic environment of the business. The social attitude towards the business, to a very considerable extent, will decide whether people will get attracted towards private business. If business gets social sanction as a respectable profession, people will feel interested in boosting the business activities. On the contrary if society, say labour, has the negative attitude towards business, a repressive system may be needed to cope up with the situation of economic disorder.

The interaction between physical environment and the economic environment in any particular country is also very significant. With a view to conserve natural resources and protect physical resources government enacts laws which may impose a consttaint on the growth and expansion of husiness. On the other hand, the scale of output, the size and location of plants and organisational set up sometimes may bring either improvement or decay in the environment. This is the reason why the business has to take care of environmental impact' of the technological advancement through social responsibility.

The other dimension of interface between the business and environment is its stability. The critical elements of husiness are-planning, direction, organisation, control and coordination. Similarly production, finance, marketing and purchasing are its main functions. All these

are influenced by the business environment. For example, in times of recession, the management may decide in favour of cutting down production. cutting down promotional efforts and keeping the financial operations at the low level. Similarly when the husiness environment changes and the government liberalises the control over the husiness, the business activities then get a boost. For example after the announcement of liberalisation, privatisation and globalisation under the New Industrial Policy in 1991 the private sector activities in the country have started growing and the international dimension of husiness has also shown a rising trend.

Business environment (consisting of economic and non-economic environment) and business operations (management) therefore influence each other. The environmental factors affect the husiness. the corporate level planning, formulation of husiness strategy and tactics. At the operational levels,' the success of husiness would depend on the capacity of the business to adjust itself to various environmental factors. When the organisational culture changes, business ethics and practices change and standards of business philosophy are reformulated. The government. lahour and society start viewing the affairs with the renewed attitude. The process thus ceases to he linear. It takes a **circular** shape. Business affects environment and the environment in turn brings out changes in the business. There is no sequence just as in a circle there is no starting poinl and no ending point. Similarly in the interface situation it is difficult to say where the interaction starts or where the interaction ends. Its a continuous process.

The challenge of macro economic management is lo adjust established policies in the light of changing domestic and international economic environment. Thus challenges can he met successfully hy ohserving the following guidelines:

- Flexibility in policy formulation to changing environment
- Stabilising efforts which permits adjustments and increases efficiency.
- Managing the system of incentive conducive to environmental happenings.
- Continuous consultation with government and public with a view to get feedback,
- Improving the information system to keep better track of the various developments,

Check Your Progress C

1. Give an example on how the environment acts as a stimulant to husiness.

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2. Explain how the physical environment is significant for husiness activities.

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3. List out the guidelines to be followed hy the business management to meet the challenges of macro economic environment.

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116 LET US SUM UP

The business environment provides the macro-economic context within which a business firm operates. Business is an activity carried on with a view to earn profit. Environment consists of various uncontrollable factors within which a husiness operates. The environment may he economic or non-economic. Economic environment consists of monetary, fiscal and economic policies of the government. Non-economic environment

includes legal, political, social, physical and cultural variables. Each element of the environment is not absolute but each interacts with one another.

Business policies and strategies have to be dynamic both at the macro as well as micro levels, Dynamism has to be in terms of adaptation to the changing environment at various levels. The success of the business would depend on the ability of the business to foresee the environmental changes and to modify its business policies and strategies accordingly. Its success would also depend upon its ability to make the environment manageable by making the environment amenable to business changes.

1.7 KEY WORDS

Consumerism : A movement of the consumers to get their rights protected andenforced,

Decision-making: The process of identifying and selecting a course of action among various alternatives to solve a specific problem.

Delegation : The act of assigning formal authority and responsibility for completion of specific activity to a subordinate.

Economic-variables : General economic factors and trends which affect the activities of an organisation.

Inputs : Environmental resources which enter into an organisational system.

Management : The process of planning, organising, leading and controlling the work of an organisation.

Mixed economy : An economic system characterised By the co-existence of private and public sectors.

Policy : A standing statement which establishes general guidelines for decision makers.

Planning : The process of establishing objectives and suitable courses of action before taking action.

Private sector : That sector of the economy where means of production are privately owned and production is carried out with profit motive.

Profit Motive : The profit earning objective which activates a producer to carry on business.

Socialism : An economic system in which means of production belong to the state.

Stratagy : The broad programme for defining and achieving an organisation's objectives.

Techonological variables : New Developments in products or processes as well as in science which may affect the organisation's activities.

1.8 TERIMINAL QUESTIONS

1. Discuss the nature and significance of Business Environment.
2. What are the three components of business environment? Discuss,
3. Explain how environment affects the business and how environment is affected by business?
4. Explain various levels of business environment with suitable examples.

Note: These questions will help you to understand tho Unit better. Try to write answers for them, hut do not send your answers to the University, These are for your practice only.

UNIT 2 ECONOMIC ENVIRONMENT — AN OVERVIEW

Structure

2.0 OBJECTIVES

After studying this unit you should be able to:

- describe the features of mixed economy in India
- outline the structure of economic planning in India
- examine the development strategies adopted in various plans
- analyse the contemporary economic reforms initiated by the government.

2.1 INTRODUCTION

In the previous unit you have studied about various components of business environment. In this unit our primary concern is the study of economic environment of business. You arc aware, environment differs not only over space but also over time within a country. Further environment is the product of past and present environments. The Indian economy of tomorrow will be influenced by what the state of the economy today and what it was like in the past.

Economic environment of business refers to the broad characteristics of the economic system in which a business firm operates. In this unit you will study economic environment in the context of economic planning, Economic planning is supposed to give a direction to the changes in economic environment,

During the struggle of India's freedom, the leaders had committed that India would after the attainment of independence, launch a programme of planned development of the country. In pursuance of this objective., the Indian National Congress, in 1938, appointed the National Planning Committee with Jawaharlal Nehru as the chairman to draft a plan for the development of India. The committee considered all aspects of planning and produced a series of reports on various subjects related with economic development. The Chairman of the Committee, Jawaharlal Nehru, became the first Prime Minister of India. His ideas and the policies initiated for the planned development of India reflected the consensus arrived at in the deliberations of the National Planning Committee. The Committee rejected the Soviet model of total ownership of the means of production by the state on the one hand and the free capitalist enterprise model on the other hand, It opted for mixed economy framework as the most suitable economic environment for India.

The Committee, therefore, felt that:

(a) The state should own or control all key industries and services, mineral resources,

railways, waterways; shipping and other public utilities and, in fact, all those large-scale industries which were likely to become monopolistic in character. In other words, the Committee specified the industries which were to be owned or controlled by the public sector;

(b) The remaining industries were to he in the private sector, but could be called upon to work in national interest. In case, the state at any stage felt that the monopolistic activities of private businessmen worked against national interest, it reserved the right to take over such industries;

(c) The Committee strongly held the view that it was not possible to draw a scheme of national planning without giving a primary place to agriculture; and

(d) The Committee aimed at doubling the standard of living of the people in 10 years,

2.2 MIXED ECONOMY IN INDIA

Soon after independence, there was lot of confusion about the environment in which the Indian economy should function. While labour leaders wanted complete transition to socialism, the capitalists within the Congress Party spoke of private capitalist enterprise environment. It was, therefore, necessary that the government should state clearly the type of economy which it intended to promote.

The choice was either to move to a complete transformation to socialism in which all the means of production (land, factories, banks, railways, transport and communications, hospitals, educational institutions, etc.) will be owned by the state. This was popularly referred to as the Soviet model. This required total nationlisation of all the spheres of economic and social activities. The other choice was to follow the capitalist model, popularly referred to as the capitalism, in which the means of production are owned by the landlords and the capitalists.

The nation, under the leadership of Jawaharlal Nehru rejected the Soviet model of socialism because it led to the emergence of a totalitarian state in which democratic freedoms were denied to citizens. Indian society worked for the democratic system of government which permitted the existence of different schools of thought. Thus the idea of the dictatorship of a party or of an individual or placing absolute power in the hands of an elite group (called as the cabinet) did not find favour in India. The command model of Soviet variety was reflected by the Indian policy in favour of democratic socialism which envisaged a mixed economy framework.

At the same time, the Indian leaders were against the capitalist model of production. Because it helped exploitation of peasants and landless workers by the landlords and of the industrial and other workers by the capitalist classes. Profit maximisation could not be accepted as the supreme goal of the society.

The government, therefore, opted for mixed economy within the parameters laid down in the Directive Principles of the Indian Constitution. The Directive Principles stated :

"The State shall, in particular, direct its policy towards securing —

(a) that citizens, men and women equally, have the right to an adequate means of livelihood.

(b) that the ownership and conuol of the resources of the community are so distributed as best to subserve the common good,

(c) that the operation of the economic system does not result in the concentration of wealth and means of production to common detriment.

The government of India, therefore, rejected both the extremes — the socialist model of the economy following the Soviet system and the capitalist model of development following the USA. It opted for a middle path which is described as the mixed economy framework in India. In such a system both the public sector and private sector were to co-exist. There is a criticism that in every economy — capitalist or socialist — public and private sectors do exist side by side. But this is a very narrow view of the co-existence of the public and the private sectors. The distinguishing feature of the Indian mixed economy

was that it aimed to deliberately enlarge the sphere of the puhlic sector so as to cover areas of defence, heavy and basic industries, infrastructure — hoth economic and social — and puhlic utilities. For development of the economy, the primary. role was given to the public sector. It was, therefore, referred to as the engine of growth.

The mixed economy framework did permit the private sector to operate in the remaining areas. However, the state emphasised that private sector should reconcile the element of self-interest with social interest. In-ease, the private sector failed to subordinate its greed for profit maximisation and continued unbridled exploitation of the working masses, the state possesses the right to takeover the control of such sector(s) of the economy. The private sector had, therefore, to work within the limits of a regulatory system so that it did not seriously come in conflict with social interest. The state, following the Directive Principles, decided to limit ownership in areas where it felt that ownership came in conflict with social interest.

In agriculture, for instance, zamindari system was abolished and the ownership of surplus lands acquired by the state after payment of compensation were transferred to small farmers and/or landless labourers. The legislation provided for ceiling on holdings, The purpose of 'the agrarian legislation was that land being the principal source of livelihood in rural areas, its ownership should he more evenly distributed. The state was not in favour o! total nationalisation of land and thus develop collective farming of the Soviet type. It had become clear that the experiment of collective farming did not increase productivity !! only increased costs of cultivation and did not provide any incentive for improving either labour productivity or land productivity in agriculture. The Government of India, therefore, promoted 'peasant proprietorship' with a ceiling on holding.

In the sphere of small scale industries, privaie ownership was accepted. The state decided to facilitate the growth of such industries hy providing credit and marketing facilities. These industries were considered important from the point of view of providing employment to a very large number of persons.

To direct investment in the desired lines of production, the state decided to nationalise banking and insurance. If it is left to the private sector, investment would be driven by market forces based on profit motive. But the areas of profit maximisation may not be areas of maximising social welfare. For example, private sector was not willing to invest in economic infrastructure such as multipurpose hydro-electric projects, irrigation, roads and communication. Similarly, private,sector may not provide adequate investment in education and health Facilities so that access to education and health facilities becomes available to the poor and deprived sections of the society.

The state, therefore, decided to undertake the development of economic infrastructure — energy, irrigation, transport and communication — in the public sector. It also sought to provide social infrastructure in the form of education and health so that the poor are enabled to acquire these facilities either free or at a very low and affordable cost, The network of schools, colleges, technical training centres, primary health centres, dispensaries, hospitals etc., had to be planned in the public sector.

During the British period, defence, heavy and basic industries were not allowed to be developed. But to have an independent industrial base for the Indian economy so as to make it self-reliant, it was considered necessary that the puhlic sector should undertake investment in defence, heavy and basic industries, Since these industries required lumpy investment and has a long gestation period, the private enterprise was unwilling to undertake investment in these areas. It sought investment in areas of short gestation and maximum profit. The state, therefore, planned the development of defence, heavy and basic industries in the public sector.

The mixed economy framework in India was particularly marked with the deliberate development of the puhlic sector in (a) defence, heavy and basic industries, (b) the development of economic and social infrastructure and (c) in controlling the commanding heights of the economy, viz., banking and insurance.

The deliberate enlargement of the public sector was symbolised by the phrase 'the development of socialist pattern of society' in the early period of planning. This was later replaced by the phrase 'democratic socialism'. The basic philosophy of democratic socialism entailed a programme of maximising production with maximum employment.

Along with this, a programme of action was initiated towards reducing economic and social disparities, thus, ensuring a national minimum level of living for all. In other words, growth with social justice within the framework of a democratic society were tasks to be accomplished under democratic socialism.

Thus, the environment provided by the mixed economy framework permitted the co-existence of both the public and private sectors on an enduring basis. Both had to work for the attainment of the socio-economic goals of planning. In unit 4 you will study in detail the framework of mixed economy and ownership patterns that have emerged.

2.3 ECONOMIC PLANNING

In 1950, the Government of India set up the Planning Commission with the objective of making an assessment of the resources of the country, both physical and human and formulate a plan for the development of the country. The Planning Commission laid down the long-term goals of planning. They were:

i) To increase production to the maximum possible extent so as to achieve higher levels. of national and per capita income;

ii) To achieve full employment;

iii) To promote industrialisation of the country with special emphasis on the growth of heavy and basic industries so as to achieve self-reliance;

iv) To reduce inequality of income and wealth; and

v) To establish a socialist pattern of society based on equality and social justice and absence of exploitation.

All the objectives were stated in the First Five Year Plan released in 1952. The First Five Year Plan stated:

"Maximum production and full employment, the attainment of economic equality or social justice which constitute the accepted objectives of planning under present day conditions are not really so many different ideas by a series of related aims which the country must work for. None of these objectives can be pursued to the exclusion of ,others, a plan of development must place balanced emphasis on all of them."

Check Your Progress **A**

1. What are the distinguishing features of the concept of mixed economy as evolved in India?

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2. List the five principal goals of planning in India. Arrange them in order of importance.

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2.4 BASIC ELEMENTS OF THE STRATEGIES FOLLOWED DURING 1956-90 (NEHRU-MAHALANOBIS STRATEGY OF DEVELOPMENT)

To solve the immediate problems of shortage of food and control of inflation, the First Five Year Plan (1951-56) adopted the strategy to achieve food self-sufficiency and also control inflation, For this purpose, it was decided to increase irrigation. The strategy worked and India was able to reduce her imports of foodgrains to just 0.5 million tonnes by the end of the year 1956. As a result of increase in food grains production and utilisation of capacities in industry, shortages of foodgrains and consumer goods were taken care of. This helped the country to stabilise the price level and control inflation. Thus the country at the end of the First Plan presented a picture of an economy which had overcome shortages of food and brought about price stability. This provided a climate for adopting a strategy for industrialisation of the economy. This strategy adopted in the Second Plan continued with some modifications till 1990.

During the Second Plan, Prof. P.C.Mahalanobis under the guidance bf Prime Minister Jawaharlal Nehru developed the heavy industry model based on the development experience of the Soviet Union. This strategy popularly known as the 'Nehru-Mahalanobis Strategy' formed the basis of the Second Plan. With minor modifications, this strategy was continued till 1977 when the Janta Party Government replaced it with the Gandhian Model of development with emphasis on small and cottage industries, but the Janta Party plan itself mentioned : It aimed at correcting the distortions in the Industrial Policy of 1956. Thus, it may be stated that the heavy industry strategy dominated the varuous plans during the period of 1956-90.

Chief Features of the Nehru-Mahalanobis Strategy of Development:

1. The strategy emphasised the rapid development of heavy industry so as to build an industrial base of the economy. The objective was to make the economy self-reliant in terms of the capital-goods sector. Arguing for the acceptance of the strategy, the Second Five Year Plan stated:

   "In the long run, the rate of industrialisation and the growth of the national economy would depend upon the increasing production of coal, electricity, iron and steel, heavy machinery, heavy chemicals and heavy industries generally— which would increase the capacity for capital formation. One important aim was to make India independent as quickly as possible of growth of producer goods so that the accumulation of capital would not be hampered by difficulties in securing supplies of essential producer goods from other countries. The heavy industry must, therefore, be expanded with all possible speed."

   The main arguments which provided justification for heavy industry strategy were :

   a) The British rule deliberately denied the development of heavy industry and kqpt India, primarily an agrarian economy as an appendage of the British colonial system.

   b) Indian industrial structure had a narrow base, mainly dependent on consumer goods industries. It was necessary to enlarge this base by the development of heavy industries and infrastructure. A diversified industrial structure, it was argued, could absorb a large proportion of labour force. This would also reduce dependence of excessive population for its livelihood on agriculture.

   c) Productivity of labour being higher in manufacturing than in agriculture, an industrialised economy promised to bring about a rapid increase in national and per capita income.

   d) Rapid industrialisation was essential, not only for the development of agriculture, but also for development of all other sectors of the economy.

2. **Role of public and private sector —** Since the private sector was not likely to undertake investments in heavy industry sector which had a long gestation period, but had low profitability, the government decided to give this responsibility to the public sector. The government conceived of the public sector as the engine of growth of

heavy industries and infrastructural facilities. The role of the private sector was complementary to the public sector in expanding the production of consumer goods and such other areas in which public sector investment was directed.

3. Role of foreign aid — Nehru-Mahalanobis Strategy admitted the use of foreign aid to facilitate the growth of capital goods and infrastructure sectors, but it emphasised the fact that major burden of development shall have to be borne by domestic savings. Since foreign aid would largely come in the form of loans, it is essential that export growth he emphasised so that bulk of imports are paid for by the increase in exports.

4. Role of small industries — Nehru-Mahalanobis Strategy was conscious of the fact that massive investments, though very essential in the heavy industry sector, would not enlarge employment significantly, since such investments are capital-intensive. It would, therefore, he necessary that in order to encourage the production of consumer goods and generate more employment, investment be made in small industry.

5. Role of agriculture — Nehru-Mahalanohis Strategy clearly understood the role of agriculture in the process of development. Nehru, recognising the important role of agriculture mentioned : "We shall find that this industrial progress cannot be achieved without agricultural advance and progress. Everyone knows that unless we are self-sufficient in agriculture we cannot have the wherewithal to advance in industries. If we have to import food, then we are doomed so far as progress is concerned. We cannot import both food and machinery."

Evaluation of **Nehru-Mahalanobis** Strategy of Development.

The main achievements of the strategy followed during 1956-90 were as under :

1. There'has been a vast expansion of the capital goods sector via the heavy industry strategy. Sixth Draft Plan of the Janata Party Government accepted this achievement in the following words: "lt is a cause of legitimate national pride that over this period a stagnant and dependent economy has been modernised and made more self-reliant."

2. There was a vast expansion in economic infrastructure in the form of irrigation, energy, transport and communications, eec.

3. There was an expansion of the social infrastructure in the form of health and educational facilities — schools, colleges, universities, primary health centres, dispensaries and hospitals.

4. A significant rise in saving and investment rates was witnessed 'in the country.

However, there were certain shortcomings noticed in the proc'ess of implementation:

1. Although agriculture did progress, hut with relatively small allocation for agriculture, the progress could not be considered adequate. Development of agriculture required greater investment in irrigation, electricity, fertilisers, implements, pesticides etc.

2. Heavy industry strategy was heavily dependent on imports for capital intensive goods. It, therefore, developed a capital-intensive pattern of development. This resulted in a relative neglect of small industries and industries producing consumer goods. Thus, heavy industry strategy created balance of payments difficulties on the one hand and failed to absorb the rapidly growing labour force, on the other, This resulted in a failure to enlarge employment adequately.

3. The public sector expansion led to the emergence of high cost economy with much less emphasis on efficiency. Both the undertakings of the Central Government and those of the State Government like state electricity boards, road transport undertakings and irrigation works etc., incurred losses year after year and the state exchequer was required to pay these losses out of the general tax revenues of the government.

4. Failure of exports to rise commensurate with the increase in imports necessitated by the expansion of the capital goods sector, resulted in the persistence of trade deficits and these deficits increased in magnitude with every successive plan.

Achievements and Failures of Planning during 1951-1990

As a result of 40 years of planning, Indian economy recorded progress on various fronts. It would, therefore, be desirable to list the major achievements of the Indian economy:

1. **Growth of national and per capita income:** During the first 30 years (1950-51 to 1980-81). national income grew at an average rate of 3.4 per cent per annum, but per capita income grew'barely by 1.2 per cent per annum. In terms of raising the level of living of the poor, this was not sufficient. However, compared td the British period (1900-1950), when national income increased merely at the rate of 0.5' per cent annually, the achievement in the planning area is significant.

Table 2.1 : Growth of national and per capita income (At 1980-81 prices)

Compound Annual Growth Rate	Net National Product	Per Capita Income
1950-51 to 1960-61	3.8	1.8
1960-61 to 1970-71	3.4	1.2
1970-71 to 1980-81	3.0	0.7
1950-51 to 1980-81	3.4	1.2
1980-81 to 1990-91	5.4	3.2

Source: CSO, National Accounts Statistics

The economy showed a much better performance during 1980-81 to 1990-91 and the national income grew at the rate of 5.4 per cent annually, and this helped to push up the growth rate of per capita income to 3.2 percent per annum which was quite significant. There is a need to not only maintain high growth rate of national income, but also to raise it further, if serious impact on the level of living has to be made.

2. **Growth of savings in India:** The rate of saving in India was just 10.4 per cent of gross domestic product in 1950-51 and as a result of 40 years of planning, the rate of savings reached a fairly high level of 24.3 per'cent in 1991-92. This is a matter of great satisfaction for the economic development of the country.

3. **Rise in per capita cereal consumption:** The per capita cereal consumption which was just 334 grams per day in 1951 increased to 471 grams in 1991— a rise by 41 per cent. This is a matter of satisfaction, but unfortunately, the per capita availability of pulses declined from 61 grams to 40 grams per clay. However, the 'overall availability of food grains showed an improvement.

4. **Improvement in the per capita consumption of several basic consumer goods:** During 1950-51 to 1990-91, per capita consumption of edible oils and vanaspati increased from 3.1 kgs. to 6.4kg. The per capita consumption of milk improved from 47kgs. in 1950-51 to 66.5 kgs. in 1990-91. The per capita consumption of cloth. increased from 11 meters in 1951 to 30 meters in 1991. It may be noted that there was a much greater use of man-made fabrics by the people which had greater durability.

   Besides this, there was much greater use of the amenities of life by a large proportion of the population. The use of bicycles, electric fans, sewing machines, refrigerators, scooters and mopeds, passenger cars, dry cells, radios and television etc. enriched the life of the people.

   On the basis of the above analysis, it can be concluded that there has been increase in the consumption of necessaries of life by the common man, though it may not be equally spread over all regions and groups.

5. **Impressive industrialization action of capital goods sector with the help of the public sector:** During the British period, capital gods sector was not developed at all.

Some consumer goods industries such as matches, sugar, cotton textiles, paper, Jute etc. were permitted to grow under the umbrella of protection. It was, therefore, essential that in a programme of industrialisation of the economy, the capital goods sector be developed. For this purpose, since private sector was not forthcoming to undertake heavy investment in capital goods industries, the responsibility was given to the public sector. As a consequence, heavy goods industries like steel, cement, locomotives, engineering, machine goods, defence industries, air craft manufacture, shipping were developed. Power and transport development was also accelerated. As a consequence, with an impressive industrialisation of the economy, India was able to provide an industrial base to its economy.

6. **Development of economic infrastructure:** Another important achievement of vital significance is the creation of economic infrastructure in the form of energy, transport and irrigation which provides the base for a programme of industrialisation. In 1950-51, road length in India was 400 thousand kms. and this increased to 1,770 thousand kms. by 1984-85 — a more than fourfold increase.

   Similarly, there has been a rapid increase in irrigation. In 1950-51, the total irrigated area was only 22.6 million hectares and by 1991-92, this increased to 72.8 million hectares. As a percentage of gross cropped area, as against 16.7 per cent in 1950-51, irrigated area accounte'd for 31 per cent in 1991-92. This sharp increase in irrigation potential gave a big boost to increase production in agriculture.

   There has been a tremendous increase in power generation and consumption of energy. Electric energy generation was merely 6.6 billion kWh in 1950-51 and it increased to 269.4 billion kWh in 1990-91. This was a tremendous achievement. Consequently, our production potential in agriculture, industry and service sector was considerably enlarged. Per capita consumption of electric energy has also risen from 13.2 kWh in 1950-51 to 220 kWh in 1990-91. This strengthened the infrastructure of the economy.

7. **Achievement of self-sufficiency in food grains and raw materials:** With the development of irrigation facilities, it was possible to undertake application of high yielding varieties (HYV) of seeds with chemical fertilizers. This water-seeds-fertilizer technology in agriculture, popularly known as green'revolution helped to boost the production of food grains from 55 million tonnes in 1950-51 to 176 million tonnes in 1990-91. As a consequence, India became self-sufficient in food grains and stopped imports of food grains. Not only that substantial increases in production of sugarcane, jute, cotton etc. were also achieved. This helped to reduce our dependence for agricultural raw materials on foreign countries and encouraged the production of our agro-based indusuies.

8. **Diversification of industrial structure:** There has been a rapid diversification of industrial infrastructure in India during the 40-year period. New industries such as steel, cement, machine tools, petroleum refining, fertilizers, power transformers, locomotives, tractors, commercial vehicles, diesel engines, dry cells, drugs and chemicals have sprung up, These industries were either in a state of infancy or had not been started in he pre-independence period. This has meant a diversification of industrial structures. All these industries required trained scientific and technical personnel to manage them. India has developed a very large technical and managerial cadre to meet the needs of a diversified industrial structure. It is claimed that India has the fourth largest pool of technical manpower in the world. This has reduced our dependence on foreign experts. Not only that, India has started exporting experts in engineering and technology to Middle East 'and African countries. Tnis is a matter of legitimate pride for our country.

9. **Diversification of exports and import substitution:** As a result of industrialisation, India's dependence on foreign countries for the import of capital goods bas declined. Similarly, a large number of consumer gdods imported earlier are being produced within the country. This has led to import substitution, Consequently, the composition of our exports has changed in favour of manufactures, mineral ores and engineering goods. The share of raw materials has considerably declined. This is an index of the indusrialisation of our economy.

To conclude, it may' be stated that India made significant achievements during 40 years of planning. These included growth of national and per capita income, a sharp increase in rate

of saving, the development of economic infrastructure in the form of energy, irrigation, transport and power generation, attainment of near self-sufficiency in food grains and agricultural raw materials, diversification of industrial structure, more especially the capital goods sector, the achievement of a substantial degree of import substitution in capital and consumer goods sector. Besides, it was able'to develop a large pool of technical manpower — the fourth largest in the world to manage the diversified industrial structure developed in India.

Failures of Planning

There were also certain fundamental failures of planning during the 40 year period.

1. **High proportion of population living in poverty:** Even after 40 years of planning, nearly 313 million persons were living below the poverty line in 1987-88. This was about 39 per cent of the total population. There is no douht that there was reduction of the proportion of population in poverty from about 55 per cent in 1973-74 to 39 per cent in 1987-88, but still the proportion was too large. The continuance of nearly 40 per cent of population living in poverty indicated a fundamental failure of planning.

2. **Continuance of unemployment and under-employment:** The planning process failed to check unemployment in India. In 1990, about 16 million persons were unemployed in the sense of open unemployment. In addition to it, about 12 million persons were severely under-employed in the beginning of 1990. The backlog of unemployment was thus of the order of 28 million. Thus, it can he concluded that the planning process failed to provide employment to the growing labour force in the country. Failure to provide employment signifies the non-fulfilment of one of the major objectives of planning.

3. **Development of an inefficient public sector:** There is no doubt that the public sector did help to provide an industrial base by establishing heavy and basic industries and by expanding the economic infrastructure, hut it is also true that public sector enterprises were either incurring losses or were yielding very low rates of returning. At the state level, the State Electricity Boards were incurring huge losses. All these losses had to be paid out 'of the general exchequer hy the people in the form of taxes. The principal causes of public sector losses were poor work ethics among the employees, low capacity utilisation, uneconomic pricing policies. overstaffing and excessive bureaucratisation and high overhead costs. Lack of autonomy to public sector executives was another major factor responsible for delay in decision-making, political interference and resulting inefficiency.

4. **Development of a license permit raj in the country:** The State, in pursuance of its Industrial Policy, developed a system of licenses and controls which acted as shackles on the freedom of the private sector to undertake investment. To set up an enterprise, a licence had to be taken from the controller of Capital Issues, Then another licence about the location of industry would be taken from the Ministry of Industry. A third licence had to be taken from the Ministry of Foreign Trade or Commerce to import plant and machinery. Business houses had to seek clearance from the Monopolies and Restrictive Trade Practices Commission (MRTPC) that they are not covered under the category of big business houses. The provisions of Foreign Exchange Regulation Act, (FERA) 1973 imposed another control. Consequently, the country developed a licence-permit raj which not only hampered investment. but gave rise to rampant corruption to procure licenses,

5. **Failure to attract foreign capital:** There is no doubt that some projects were developed with the help of foreign capital, but a large number of restrictions placed on the entry of foreign capital also prevented the free flow of foreign capital. As a result, the share of foreign capital remained very low in our economy, This resulted in lack of technical up gradation in various lines of production. Foreign collaborations which could have helped to provide supplementary savings as also improved technology and helped to strengthen infrastructure could not he attracted. Consequently, Indian industrial and infrastructural development suffered.

6. **Unnecessary emphasis on concentration of economic power:** Under socialist rhetoric, the Government has been over-emphasizing the issue of concentration of economic power. Thus, it imposed restrictions on hig business to undertake investment.

This meant that big business houses could not invest in areas requiring lumpy or large investment. Consequently, this led to unauthorized expansion of capacity which was later ratified by the Government. It also resulted in the growth of a parallel economy, popularly described as 'black economy'. All the evil effects of black money were the consequence of an unnecessary restrictions on the big business in the private sector to undertake investment.

7. Failure to **check intlotion: A** fundamental weakness of 40 years of planning was its, failure to check the rise of prices. Between 1981-82 and 1991-92, the wholesale price index rose on an average hy nearly 8 per cent per annum. This sharp rise of prices hit the common man whose real income failed to keep pace with the rising prices.

The major failures of planning during the 40 years period (1950-51 to 1990-91) necessitated rethinking about the future course of economic policy to be followed. The major issue was: should a restrictionist policy be continued or the economy should move towards liberalisation. The economic reforms introduced in 1991 by the new industrial policy were a response to the major failures of planning and our socialistic bias with over-emphasis on puhlic sector.

Check Your Progress B

1. Was Nehru-Mahalanobis Strategy justified at the time of formulation of the Second Plan? If so, give reasons.

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2. If not, give reasons.

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2.5 CONTEMPORARY ECONOMIC REFORMS

The installation of the Congress (I) government led by P.V.Narasimha Rao in 1991 brought about a radical change in economic policy. The main objectives of the new economic reforms wae:

1. To free Indian economy from bureaucratic controls and excessive regulatory mechanisms.
2. To open areas hitherto resewed for the public sector to the private sector since the public sector enterprises had shown a very low rate of return or were incurring losses year after year.
3. To liberalise the economy with a view to integrate it with the .world economy.
4. To remove restrictions on direct foreign investment.
5. To remove restrictions on industrial and business houses to undertake investments by abolishing the ceiling limit of assets prescribed by the Monopolies and Restrictive Trade Practices (MRTP) Act.

The main emphasis of economic reforms is on privatisation and globalisation of the economy. Although the government Wiled to transfer the ownership of public sector undertakings to the private sector in view of the strong opposition by the workers and **left**

parties, it did succeed in the liberalisation of the economy and opened areas of heavy industry and economic infrastructure to the private sector — hoth domestic and foreign.

The economic reforms initiated in 1991 were the basis of the planning strategy of the Eighth Plan (1992-97).

Planning Strategy during the Eighth Plan (1992-97)

The planning strategy redefined the role of the public sector:

a) Public sector investment to be limited to areas of infrastructure development for facilitating growth; and

h) Public sector to concentrate on areas to meet social needs like health and education as also to undertake public distribution system to protect the weaker sections of the society.

Strategy of the Eighth Plan was judicious use of market mechanism and planning to meet social goals. Growth rate of the economy picked up and was around 6.3% in 1994-95.

Foreign exchange reserves peaked to $21 billion.

These were welcome developments, but the situation from the point of view of social justice was not comfortable.

a) Consumer Price Index rose by 11.6% on the average.

b) Number of poor and population below the poverty line did not show a marked decline.

c) Employment target lagged behind.

Eighth Plan record may be satisfactory on the growth front, hut the market-oriented strategy has failed the people on the front of social Justice.

Check Your Progress C

1. Give the two main objectives of contemporary economic reforms in India.

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2.6 LET US SUM UP

During the freedom struggle, the Congress set up National Planning Committee with Jawaharlal Nehru as its chairman to draft a plan for the economic development of the country. The Committee rejected the Soviet model of total ownership of means of production on the one hand and the free capitalist model of development on the other. It opted for mixed economy framework.

The Indian society did not favour either the Soviet model of total nationalisation leading to a command economy, or the capitalist model of development with total ownership in the hands of capitalists and landlords; but it preferred to evolve a society based on 'democratic socialism' which envisaged the mixed economy framework.

Mixed economy accepted the co-existence of the public and the private sector. However, the distinguishing feature of the Indian Mixed Economy was that it aimed to deliberately enlarge the sphere of the public sector so as to cover areas of defence, heavy and basic industries, economic and social infrastructure and public utilities. The public sector was to act as the engine of growth. The remaining sectors were left open for the private sector hut the private sector was expected to work within the limits of regulatory system designed by the state, The state decided to limit ownership in such areas where it was believed that it came in conflict with social interest.

National Planning Commission was set up in 1950 and was assigned the task of formulating a plan for the economic development of India. The Commission laid down the long-term goals of planning: a) To increase production to the maximum possible extent so as to achieve higher levels of national and per capita income; b) To achieve full employment; c) To promote industrialisation of the economy with special emphasis on the growth of heavy and basic industries so as to achieve self-reliance; d) To reduce inequalities of income and wealth; and e) To establish a socialist pattern of society based on equality and social justice and absence of exploitation.

Economic reforms bringing about radical changes in economic policy were introduced in 1991. The main objectives were: a) To free the Indian economy from excessive bureaucratic controls; b) To open areas hitherto reserved for the public sector to private sector; c) To integrate the Indian economy with the world economy; d) To remove restrictions on foreign direct investment; and e) To remove restrictions on industrial and business houses to undertake investments by abolishing the ceiling limit on assets as prescribed by MRTP Act.

The main emphasis of the reforms is on privatisation and globalisation. Strategy of the Eighth Plan (1992-97) was based on new economic reforms. It redefined the role of the public sector. a) Public sector to be limited to areas infrastructure; and b) Public sector to concentrate on social infrastructure — health and education and public distribution system for the weaker sections of society.

Eighth Plan succeeded in achieving a high average annual growth rate of 6.1 per cent and building foreign'exchange reserves, but it failed the people on the front of social justice — consumer price index rose by 11.6 per cent. The average percentage of population below the poverty line did not decline and employment target lagged behind.

2.7 KEYWORDS

Capitalist Model of Development: refers to the system in which all the means of production are under the ownership and management of a class known as capitalists who use these means of production with the sole aim of protit'maxirnisation.

Command Model: refers to the Soviet type of planned development where all decisions about production and distribution are centralized in a supreme authority. It is only on the dictates of the centralised supreme authority that the system operates, irrespective of the market signals.

Commanding Heights of the Economy: the term was used with reference to congrol of 'banking and insurance'. Left to the market forces, investment will be directed by market forces, but in case, banking' and insurance are nationalised, the control of investment decisions in socially desirable channels can be exercised by the state.

Democratic Socialism: economic growth with social justice within the framework of a democratic society, thus ensuring minimum level for all and a programme of maximum employment, along with a programme of action reducing economic and social disparities.

Economic Infrastructure: indicates creation of infrastructure in the torm of irrigation, energy, transport and communications.

Globalisation: refers to the process by which the economy of the country is integrated with the world economy. It involves four parameters: (i) Reduction of trade barriers so as to permit free flow of goods and services across national frontiers; (ii) Creation of an environment in which free flow of capital can take place among nation-states; (iii) Creation of an environment permitting free flow of technology; and (iv) Creation of an environment in which free movement of labour can take place in different countries,

Plan Holiday: A term coined to describe the period in which the country abandoned the formulation of the five year plans and shifted to a system of annual plans. The period referred to was 1966-67 to 1968-69.

Privatisation: refers to transfer of ownership of a public sector undertaking to the' private sector — may be company, a workers' cooperative or an individual. When 100 per cent ownership is transferred, it is a case of denationalisation. Transfer of ownership can be partial as well. In such cases, the public sector undertaking is transformed into a joint venture.

Public Distribution System: refers to the system of fair price shops to distribute articles of essential consumption to the poor at reasonable prices. The government takes the responsibility to procure and distribute essential commodities.

Social Infrastructure: indicates infrastructure in the form of schools, colleges, technical training institutes, primary health centres, hospitals, family planning and welfare centres etc.

2.8 TERMINAL QUESTIONS

1. Discuss the main elements of the concept af mixed economy developed in India. Do you consider it to be a desirable environment from the socio-economic point of view?
2. Discuss the long-term goals of planning in India. How far have they been achieved after 40 years of planning?
3. Discuss the main elements of Nehru-Mahalanobis Strategy of development. Give its principal achievements and shortcomings.
4. Discuss the rationale of contemporary economic reforms initiated after 1991.

Note: These questions will help you to understand the Unit better. Try to write answers for them, hut do not send your answers to the University. These are for your practice only.

UNIT 3 SOCIAL AND CULTURAL ENVIRONMENT

Structure

3.0 OBJECTIVES

After studying this unit you should be able to:

- explain the nature of evolving social institutions in India
- outline the quantitative and qualitative aspects of demographic changes in our country
- identify the cultural factors that have a bearing on the social environment
- describe the impact of technological change on society
- explain the causes and effects of changing value system
- critically examine the case for and against social responsibilities of business
- appreciate how ecological issues are sought to be resolved.

3.1 INTRODUCTION

In the first two Units of Block 1, you have learnt the meaning, importance and the eomponents, of business environment, followed by an overview of Indian economic environment. In this Unit, you will have an understanding of the various dimensions of the social and cultural environment of business with particular reference to the Indian scene. Specifically we shall discuss the evolving social institutions in India, quantitative and qualitative aspects of demographic changes, cultural factors in the social milieu, the impact of changing technology on society, the changing value system in the Indian social set up, viewpoints on the question of business assuming social responsibilities, and the ecological issues attracting serious attention in modern times.

3.2 EVOLVING SOCIAL INSTITUTIONS

Business including trade and industry to-day happen to he integral parts of the social system. Over ages, the complexion of society has changed. in many ways, and so have the nature and forms of business enterprises. A pluralistic society has evolved from the monistic society of the past. The difference should he noted for an understanding of the complex nature of interactions between social institutions.

Monistic Society

In the monistic society of the past, human activities were undertaken in the context of a single social institution - the village community. In such a society, the activities of all were governed by customs and tradition, and the village elders guided the conduct of all others. The occupations of people were largely determined by the castes to which they belonged.

Social stratification was mainly based on castes and occupations. People born in lower castes were expected to be subservient to those of upper castes. Pursuit of certain occupations was not as honorable as that .of others. Merchants and traders were assigned lower status in society inspite of their wealth and riches, while people pursuing the learned professions of teaching and medicine enjoyed higher status.

Pluralistic Society

The monistic society has gradually evolved into the pluralistic society in which there are numerous groups constituting the social system. The groups are organized to serve economic, social, political, religious and professional interests of members. Although people act individually in their own interests, they are organized in groups and form institutions to maintain and protect their common interests. Thus, there are different institutions to serve the diverse interests of people.

Interaction Between Social System and Business

In the process of interaction with the social system, business is influenced by different interest groups and institutions. It also exerts a corresponding inlluence on different institutions and'interest groups. Thus the freedom of business is restricted hy Government representing the public interest, labour unions representing the workers' interest, and NGOs representing consumer interests. On the other hand, large business corporations not only influence government policies, but also check the claims of labour unions for higher wages and better working conditions. Associations of business interests also possess considerable political and social power so as to influence public opinion.

Over time, far reaching changes have also taken place in the traditional social institutions. People are no longer hound down to the occupations traditionally related with castes. They have opportunities to adopt any occupation of their choice which is within their competence. This has followed industrial growth and the emergence of large scale organisations which have changed the occupational patterns and people's attitude to work. 'The traditional occupations based on hereditary skills and linked with caste groups have lost their significance. Simple living and high thinking as ideals have given place to people's aspiration for higher living standards. Social status' is more often determined on the basis of income levels and wealth of people.

Spread of educational opportunities along with improvement in transport and communication facilities have resulted in greater mobility of people and their concentration in urban centres. The institution of joint family is' gradually breaking down partly due to the mobility of family members and partly due to differences in earnings of individual members of the family.

Life styles and norms of consumption have also changed with changing occupational Patterns. The traditional role of women as housewives has changed with wonlen joining workforce in larger numbers and working side by side with men in various types of jobs. This has followed the spread of women's education and unitary families striving for better living standards.

Underlying the changes in social institutions are forces of change in the social milieu — demographic, cultural and technological changes — which are discussed in the following sections.

Check Your Progress A

1. Distinguish between Monistic society and Pluralistic society.

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2. State whether the following statements are True or False.

   i) Customs and traditions had overwhelming importance in the monistic society.

   ii) Earning money and amassing wealth were considered to be crimes and so those guilty of such crime were punished in the traditional society.

   iii) In the modern pluralistic society people can acquire skills other than hereditary skills and choose any occupation suited to their competence.

   iv) Multiple interest groups provide a system of checks and balances in the pluralistic society.

   v) In a modern society group interests are more important than individual interests.

33 DEMOGRAPHIC CHANGES

The size and quality of population that constitute the demographic position of a country are important dimensions of the social environment. To start with, it may be useful to examine the theory of demographic transition which provides an explanation of the causes of demographic changes.

The theory of demographic transition suggests that the rate of growth of population is dependent upon the stage of economic development. Thus, in a primitive agrarian society, the growth rate of population is either stagnant or very low due to high birth rate coupled with a high death rate. High birth rate is the result of widespread illiteracy, early marriage, and lack of knowledge about family planning. Death rate is also high as a consequence of poverty, lack of nutritive diet, primitive sanitation, absence of medical care, and incidence of epidemics. This stage is referred to as the first stage of demographic transition.

A developing country where industrial development has been initiated faces a rapid increase in population. This is described as the second stage of demographic transition. At this stage, while death rate falls rapidly on account of improved medical services, fall in infant mortality and a better standard of living, birth rate continues to be high as social customs do not change fast, nor does illiteracy and lack of knowledge about family planning. The process of development at this stage is slow and growth of population outpaces the rate of economic growth giving rise to a vicious circle. Along side this stage of population explosion, there is a twilight phase of development wherein large number of poor people who might have otherwise died without the benefits of modern health technology or death control devices are 'saved'. But these survivors continue to live in a state of sub-standard health, poor nutrition, and poor educational attainment, which erodes the quality of human life.

The third stage of demographic transition is related with developed countries. The birth rate at this stage declines faster on account of mass literacy, extensive use of birth control devices and high standard of living. The death rate also falls considerably due to public health measures.

Demographic Changes in India

From the above description of the stages of demographic transition, it would appear thal India is in the second stage of transition. However, to get a clear picture, demographic changes in India need to .be studied with respect to hoth quantitative and qualitative aspects of population. The quantitative aspects of change are manifested in the size of population, growth rate and density of population, while the qualitative aspects of change are reflected in the life expectancy, age and sex composition, rural-urban distribution, literacy, etc.

3.3.1 Quantitative Aspects

India has been the second largest populated country in the world next to China. The size of India's population increased from 36.10 crore in 1951 to 84.39 crore in 1991(Table 3.1) It is likely to cross the 100 crore mark hy ,2000 A.D.

Table 3.1 : Growth of population, 1951-91

Year	Population (crore)	Increase over the previous decade (crore)
1951	36.10	4.23
1961	43.90	7.80
1971	54.80	10.90
1981	68.33	13.53
1991	84.39	16.06

The rapid growth in the size of population reflects higher growth .rates. Indeed the population has been growing until 1971 at an increasing rate as shown below (Table **3.2).**

Table 3.2 : Birth rate, death rate and natural growth rate of population in India (rate per annum per thousand people)

Decade	Crude Birth Rate	Crude Death Rate	Natural Growth Rate
1941-51	39.9	27.4	12.5
1951-61	41.7	22.8	18.9
1961-71	41.2	19.0	22.2
1971-81	37.2	15.0	22.2
1981-91	32.5	11.4	21.1

(Source: Eighth Five Year Plan, Vol.I. P.22)

The rate of growth of population is a function of migration, birth rale and death rate. In India, the change in population caused by net migration as a proportion of total population is insignificant. Thus, it is the difference between hirth rale and death rate which measures the growth rate of population. Till the 60's, the death rate has been falling faster than the birth rate. The rates conformed to the general trends of the second stage of demographic transition, As shown in the above table, during 1951-71, there was no significant fall in the birlh rate while the death rate continued to decline. Thus the natural growth rate of population went upto reach a maximum of **22.2** per thousand or **2.22** per cent per annum during 1961-81.

The rate of growth marginally declined to 2.11 per cent per annum during 1981-91. Beginning with the 70's one may consider the stage set for transition to the third phase of demographic transition. According to projections of the rate of population growth, during 1992-97, the downward trend of birth rate was likely to have fallen lo 27 per thousand and the death rate to 9.2 per thousand, with the natural growth rate being 17.8.

A high density of population (the ratio of number of persons per sq.km of land area) is another feature of India's demographic profile. The average density is 267 and this is considered to be a fairly high rate. There is no empirical evidence to suggest any relationship between density of population and economic development. There are countries with low density of population some of which have low and some high per capita income. India with a density of 267 has a per capita income of $ 350, while Japan with a density of 316 has a per capita income of $25,430. The implication of density of population is the magnitude of the burden on land area and the potential of growth. Thus India's high density is indicative of a high burden on land which is likely to increase further with additions to population.

3.3.2 Qualitative Aspects

The qualitative aspects of demographic change relate to life expectancy, age and sex composition, rural-urban distribution, literacy and such other dimensions.

The health and general level of mortality of a community is reflected in the measure of mean expectation of life at birth. If death occurs at an early age or death rate is high, the expectancy of life is low; Contrarily, if death occurs at an advance age and death rate is low, there is high life expectancy. Over the years since independence, there has been a perceptible fill in the death rate in India and a correspondingrise in life expectancy. From an average of 32.1 during 1941-51, it had increased to 45.6 during 1961-70,and 59.4 during 1989-93. The projected life expectancy is 65 around 2000 A.D. Females have always had a slightly higher life expectancy than males.

Even though life expectancy has been rising in India, the average expectancy is much lower than that in many Asian countries like China(68.8), Thailand(69.2), Sri Lanka(72.9), Malaysia(70.9), Republic'of Korea(71.3). State-wise, there has been considerable differences in life expectancy. In Kerala, life-expectancy has been 72.0 during 1989-93. It has been 66.4 in Punjab, 64.2 in Maharashtra, 61.5 in West Bengal, 55.9 in U.P., 55.5 in Orissa, 54.9 in Assam, and 54.0 in Madhya Pradesh, during the same period. The implication of rising life expectancy may be an increasing pressure on the job market. People at retirement age being At to work may seek extension of fresh employment. The number of joint or multi-generational families may tend to rise along with a rise in the average size of households.

Age Composition

Changes in age and sex composition are worth noting mainly because these reflect changes in the size of working population and job seekers, and the role of women in society. The age-composition of population in India is given below(Table 3.3).

Table 3 3 : Age-composition of population

(Percentages)

Age-Group	1990	1995	2000 (Projected)
0-14	36.00	34.62	31.36
15-59	57.50	58.43	60.79
60 & above	6.5	6.95	7.58

(Source: Eighth' Five Year Plan, Vol.I,p 26)

The data show what may be called a 'bottom heavy' age pyramid, the proportion of young. in the total population being substantially high and growing. The age distribution also indicates the dependency ratio i.e;, the average number of dependents on an earning person. The dependency ratio of the Indian population works out to about '50 p.c. (taking into account the unemployed persons in the working age group, 15-59). This level of dependency ratio acts as a drag on production and improvement in living standard. It also has an impact on the rate of savings, investment, education and welfare. However, with declining birth rate the age composition is expected to change resulting in a reduction in the dependency ratio and increase in the proportion of the working age-group. The projected age-composition shows that by 2000 A.D., the proportion of population in the

working age-group may go upto 60-80 per cent. Thus, inspite of a projected decline in the growth rate of population, the absolute number of job seekers is likely to increase over time.

Sex-Composition

The change in sex-composition or sex-ratio (the ratio of women to men) is a significant factor in the analysis of social well being and reflects the relative change in the survival of women vis a vis men. In India, the population of females per 1000 males shows a declining trend - from 962 in 1901 to 930 in 1971 and 929 in 1991. A higher ratio of males in the population is associated with a rising tendency towards masculinity. The comparative position in most other countries is a higher ratio of females than males in the population. For example, the sex ratio in USA is 1055. in UK 1069. Japan 1171 and Germany 1118. Indeed the sex ratio in India is perhaps the lowest in the world. This indicates high mortality and under-nourishment among women, and the low status of women in society. One can explain the decline in sex ratio over time having been caused hy. several factors, e.g. females being discriminated against in providing adequate nutrition, access to health and other amenities, female selective termination of pregnancy, possibly female infanticide as well.

It is arguable that if the mortality at child birth falls. and the general status of women, particularly in rural areas, improves, the sex ratio will increase. The state-wise comparison of sex ratios corroborates this contention. The sex ratio is relatively higher in the states where the status of women is better, like in Kerala where it is 1040. and in Tamil Nadu where it is 972, hut it is only 814 in Haryana where women presumably have a low status in society.

Urbanization

Economic development along with industrial growth is generally associated with urbanization of society. However, India continues to have a predominantly rural population even though the proportion of people living in urban areas has progressively increased since 1951. The share of urban population in the total population has gone up from 17.6 per cent in 1951 to 18.3 in 1961. and to 20.2 per cent in 1991. It is projected to he around 32 per cent in the year 2000 A.D. The rate of growth of urban population has increased over the years. During 1951-61, it was estimated at 34 per cent which increased to 38 per cent during 1961-71 and 47.01 per cent during 1971-81. but declined lo 36.91 per cent during 1981-91.

Concentration of population in urban areas has led to growth of slums with unhygienic living conditions and other problems. Remedies to these problems have been sough hy developing satellite towns and dispersal of manufacturing industries to the hinterland.

Literacy

Another qualitative aspect of demographic change is literacy. There is a close positive relationship between education and level of economic well being. According to a World Bank Report. developing countries with high literacy rates have tended to prow faster even after allowances are made for differences in income and physical investment. and they have higher physical investment rates. Empirically, it has been established that a high degree of correlation exists between literacy rates and other development indicators, The female literacy rate at age 15 and over is positively correlated with percentage of female workers in modern occupations, age at marriage, and use of contraceptives. It is strongly and negatively correlated with infant mortality and fertility.

The literacy rate in India has increased from 18.3 % in 1951 to 28.3% in 1961, 34.5% in 1971. 43.6 % in 1981, and 52.2% in 1991. However. there are wide variations in these rates between the states. The average rate during 1989-93 and centered at 1991 was as high as 89.89 per cent in Kerala, and as low as 38.5 per cent in Bihar. The correlation between literacy rate and other indicators of demographic profile can he seen from the following figures (Tale 3.4).

Literacy rates have also been quite different with respect to males and females, as well as between rural and urban population. In 1991, 64.134 of the male population and 39.29% of the female population were literates giving an overall literacy rate of 52.21%. On the

other hand, the proportion of literacy among males was 69% in urban areas as against 42% in rural areas; similarly, the literacy rate among females in urban areas has been 51% as against 19% in the rural areas.

Table 3.4 : State-wise literacy rates and other indicators

State	Literacy Rate (%) (1991)	Infant Mortality Rate (per 1000)	Death Rate (per 1000)	Birth Rate (per 1000)
Andhra Pradesh	44.09	66	8.3	24.0
Assam	52.89	77	9.6	29.3
Bihar	38.48	73	10.5	32.1
Gujarat	61.29	62	7.6	26.7
Haryana	55.85	68	8.0	30.0
Karnataka	56.04	62	7.6	24.2
Kerala	89.81	16	6.0	17.7
Madhya Pradesh	44.20	99	11.1	33.0
Maharashtra	64.87	55	7.0	24.5
Orissa	49.09	103	10.8	27.7
Punjab	58.51	54	7.3	24.7
Rajasthan	38.55	85	9.1	33.2
Tamil Nadu	62.66	56	7.9	20.2
Uttar Pradesh	41.60	86	10.4	34.7
West Bengal	57.70	59	7.7	23.6
All India	52.21	74	9.0	28.3

(Source: Govt. of India, Economic Survey, 1996-97, p.185)

Literacy rates have also been quite different with respect to males and females, as well as between rural and urban population. In 1991, 64.13% of the male population and 39.29% of the female population were literates giving an overall literacy rate of 52.21%. On the other hand, the proportion of literacy among males was 69% in urban areas as against 42% in rural areas; similarly, the literacy rate among females in urban areas has been 51% against 19% in the rural areas;'

Check Your Progress B

1. Why does the growth rate of population increase in the second stage of demographic transition?

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2. What are the likely effects of

   a) rising life expectancy in India?

   b) high density of population?

   c) a 'bottom heavy' age pyramid?

d) high dependency ratio?

a)

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b)

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c)

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d)

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3. 'Indicate the correlates of high and low literacy rates with other indicators of demographic profile citing examples of any two states in India.

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3.4 CULTURAL FACTORS

The term 'culture' includes values, norms, artifacts and accepted behaviour pattern of people that a society may have developed over time. Culture is also defined as the totality of behaviour that human beings in any .society learn from their elders and pass on to the younger generation. In the sense culture may be regarded as the learned responses of a particular society.

The cultural change which has taken place and is still continuing in our country has been caused by the advancement of science and technology, growth of large-scale industries, .and improvement in the systems of transport and communication within and across the borders of India, Industrial development has created demand for varied types of goods and services, changed people's tastes and preferences, which in. turn have influenced their habits and customs.

Religion

Religion is an important element of culture. It governs people's attitude towards human activities, their moral values and ethics. In India, the prejudice against business, perceived to be concerned with 'making money' as a way of life, originated with religion. It has changed substantially over time, Honesty, truthfulness, and sympathy for people in distress are certain fundamental values which go with religion and are still cherished by people. However, while religion as a social force has provided strong emotional bonds among people, religious orthodoxy has made people sectarian in outlook, dogmatic and intolerant of others' views.

The Indian society includes people who follow different religions, Within particular religious communities, there are different sects and cults: People practice religious rites according to their own faith. Their beliefs, habits and customs as also values reflect their

religion in many ways. In this context, secularism is regarded as a valued aspect of Indian cultute. It refers to the idea that the state, moral principles, education, etc. should be independent of religion. The Constitution of India has laid down that while people will be free to pursue their own religion, the state will be independent of any religion. India is thus declared as a secular state. While people follow their own religious practices in their private and social life, that does not affect their work life,

The importance of secularism will be appreciated if we examine its beneficial effects. **First,** there is no discrimination expected to be ma& between people of different religious faiths in public life related with education, employment and official work. **Second,** common problems may be approached unitedly by people of various religions and faith. Business in India is free from any bias towards customers on religious grounds except in the case of food products. Moreover, since the basic values and morals of all religions are the same, unity among people can be sustained on common grounds.

Values

Values constitute another important element of culture. People in every society have basic convictions that certain modes of conduct or goals are desirable. These 'are known as values. Value system represents a set of values with priority ordering based on their relative importance; It prompts individuals and groups to distinguish between what is right and what is wrong, what "ought to be" and what "ought not to be".

Values may be classified into different types to identify their relative importance in the social context. Thus we may distinguish between 'theoretical values' (truth and rationality), 'economic values' (material gain and practicability), 'social values', (love of people, equality), 'political values' (acquisition of power), 'religious values' (morality, righteous conduct), and 'utilitarian values' (maximum good for the maximum number): The priority accorded to particular values may differ depending on the culture and tradition of societies, or it may differ between interest groups within a society..

Thus values which predominate in western societies differ from those that prevail in Asian countries. However, values are not necessarily static, Religious values predominated in the western world in the Middle Ages. A complete reversal has taken place through the intervening centuries. Acquisition of money and wealth (economic values) considered vices in the Middle Ages became major virtues in the era of capitalism. This has happened also in the underdeveloped countries at a later stage, During the last fifty years since independence, people in India have imbibed modern western values, particularly In urban areas. Emphasis has been and is shifting from religious and social values to economic and political values.

3.5 TECHNOLOGY AND SOCIAL CHANGE

Advancement of technolagy has been one of the most important factors causing far reaching social changes. In a dynamic social setting, technology often operates as a multiplier. For instance, discovery of internal combustion engine and the technology of automobile manufacture not only had a profound effect on the transportation of goods and passengers and mobility of people, but it also led to changes in the locatioa of habitats, consumption patterns and life styles. Another significant effect of technological progress has been greater productivity as well as improvement in the quality of products. The beneficial effects of higher productivity and improved quality have spread throughout the social **system,** and led to a better and more secure life for increasing numbers of people, Over time, technological progress has resulted in better living standards, reduced incidence of diseases, and ensured control over environmental &gradation.

The modern telecommunication system is also the result of technological progress. Dissemination of knowledge and information has been rendered much easier as a consequence of the facility of instantaneous communication over distant territories. It has brought about enormous saving in time and energy. The system of distance education through Tele-conferences and other communication devices has also made a significant impact On systematic learning. Advertising through audio-visual, electronic media (television) has facilitated marketing of new products and improved varieties of existing products,

Technological advancement has also led to increased efficiency and economy of operations through labour-saving devices' and substitution of manual work hy automation, necessitating the employment of technically skilled manpower to an increasing extent. Computerization of accounting, storage and processing of data is gradually replacing manual operations in larger organisations. *FAX* and INTERNET facilities are being increasingly used for correspondence and transmission of documents.

Overall, a modern society today is characterized hy systems of production, distribution, transportation and communication, all of which are based on technological changes over the last two centuries. This has not only resulted in a hetter standard of living for larger numbers of people, but also provided for a variety of services over wider territories, and above all improved medical and health care facilities for people in general.

However, technological changes have also brought about several socially undesirable consequences. Indiscriminate use of scarce natural resources, deforestation, and environmental pollution are some of the direct results of economic growth through technological changes. Insatiable consumerism has led to the subordination of moral values to materialistic Glues, elevation of machines over human beings, and deterioration of human values.

Check Your Progress ***C***

1. What is meant by 'culture'?

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2. Why is secularism regarded as a valued aspect of Indian culture ?

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3. Briefly explain how technological change may have a multiplier effect.

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4. State whether the following statements are True of False.

   i) Values may differ depending on the culture and tradition of societies.

   ii) Cultural change in India has been caused hy scientific and technological changes.

   iii) Technological advancement is not an unmixed blessing.

   iv) Labour-saving devices cause unemployment of people hut it may not be so if people are trained to use machines.

3.6 CHANGING VALUE SYSTEM

Before explaining the significance of changing value systein in society, it is necessary to explain the meaning of individual values and social values.

Individual values may be defined as the normative views held by individuals of what is good and desirable. Values thus provide standards or bench marks by which individuals may be guided in their choice of decision, conduct and behaviour.

Social values may be defined as a-system of shared beliefs about desired goals and norms of human conduct. Thus, for instance, individualism may be considered desirable in a system of social values where by people may decide to pursue their individual interests in work life and compete with others. In such a society, indeed in most societies, high value is attached to winning in competitive situations. However, there are social norms as well

which suggest how a winner or loser should behave. People look upon with displeasure an arrogant winner as well as a complaining loser.

Value system refers to a set of values with priority-rating based on their relative importance. For instance, people in different walks of life are known to rank values in varying orders of importance. Business executives rank 'economic values' (like material gain and practicability) higher than 'social values' (love of people, equality). Business decisions are made on that basis. On the other hand, in a system of social values, 'theoretical values'(truth, honesty and rationality) may be rated higher than 'economic values'. Again, in a system of social values, 'religious values' (morality, righteousness) may be rated higher than all other values, We have discussed earlier (section **3.4)** the types of values which may be distinguished for identifying their relative importance.

The stability of a society depends, among other things, on its value system. The development of a society cannot he thought of without making note of the value system. However, values and value systems are not static concepts. Value systems may change. Indeed, traditional value systems have yielded place to modern value systems in many societies. This has also happened in India particularly with the urban population and the process of change is also noticeable in rural areas. The nature and causes of **change** are outlined below:

1. With the spread of education and awareness of value systems in economically developed countries, greater importance is now attached to economic values **and** pursuit of material gain. Practicability of decisions are increasingly reflected in the conduct of people. Similarly, political values which emphasize acquisition of **power** as desirable have provided a large section of educated Indians. Consequently, social values and religious values have lost their importaace.

2. Industrial growth and recognition of the Importance of trade, money and exchange operations, have led people to believe that earning profit, accumulating wealth, lending money and investing capital could not be prejudicial to society. Pursuit of self-interest and individualism as cherished values have swept the outlook of many in recent **times. At** the same time erosion of moral values like righteousness, honesty and truthfulness seems to threaten the social fabric.

3. Increasingly, there has been growing consciousness of the need to imbibe democratic norms (establishing equality of rights) as a result of which certain cultural values like legitimacy of human dignity and recognition of human rights have been growing in importance.

Business Values

Business values are known to influence social values in no small degree. The business class exerts considerable influence on institutions and interest groups due to its social **and** political power and ability to mould public opinion on social issues. The power of big business houses over government policies is a long-established fact. To quote Miliband (The State in Capitalist Society, published in 1969), "Control by business of large and crucially important areas of economic life makes it extremely difficult for governments to impose upon it policies to which it is firmly opposed." Referring to the reformist zeal **with** which the Labour Party came to power in Britain in 1967, Miliband noted that the Labour Government had to hold private talks with the business community to convince them that their views will be of central importance in the Government's planning of its economic policies.

Values which govern decision-making in corporate enterprises may be said to consist of individual values, group values, values of the constituents of the socio-economic environment (customers, suppliers, competitors, government agencies), and cultural values af the society. Business 'values consist.of the criteria which define what constitutes good business, what objectives are desirable to pursue, and whose interest should **business** serve. Should business be conducted to serve the private interests of only the owners? Should executives be guided in their action only with an eye to maximizing profits irrespective of the means ,adopted for the purpose ? Should workers be entitled to share in the prosperity of the business? Answers to these and similar questions reflect the value system of society.

With the change in social values and with a view to bringing about a change in business values, Government of India has enacted various social legislations. These include: prevention and control of air and water pollution, environment protection, payment of productivity and profit bonus to employees: consumer protection and consumer welfare, prohibition of benami transactions, etc. At the same time, large business corporations have been conscious of their social responsibilities, that is their responsibilities towards the shareholders including the community and public in general.

Check Your Progress D

1. What is meant by the term 'value system' ?

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2. Give two examples to illustrate the change in value system in Indian society,

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3.7 SOCIAL RESPONSIBILITIES OF BUSINESS

Business activities today have a dominant influence on the life of citizens and the society in different ways. In pre-modern times, it was not necessary for businessmen to be concerned with the 'social' value issues of business since values were expected to he upheld by market forces. The success of a business in itself was taken as prima facie evidence of the social value of that business over its less successful competitor. This view has been discarded by social scientists in modern times. It is now widely recognized that business not only involves pursuing economic gains resulting from customer satisfaction, it is also a social function involving certain ohligations to society. Social responsihility of business refers to the obligation of business firms to adopt policies and lines of action which are desirable in terms of the expectations and interests of society. However, classical economists - Milton Friedman, F.A.Hayek and Gilber Burck - held a different view till the early 70's. Let us examine the views against business assuming social responsibilities.

3.7.1 Views against Social Responsibility of Business

1) The foremost argument against social responsihility of husiness is that in a free-enterprise system, a business executive cannot spend his employer's (i.e. owner's) money for social purposes. If he does so, he in effect becomes a civil servant, but he was not selected to act as a civil servant. He may not he competent to act as such. He was employed as an expert in running a business, not as an expert in public affairs.

2) The second line of argument is that with free enterprise and division of labour, so long as resources get into the control of the enterprise willing to pay the highest price, the resources will then, on the whole, also he used where these will make the highest contribution to the product of: the society. This will follow if each enterprise while deciding on the use of resources considers only those' effects as will raise the value of its assets, and does not concern itself with the question whether a particular use is socially beneficial. At the same time, if management is allowed to be guided in the use of funds by what they consider to be their social responsibility, it would create centres of uncontrollable power never intended hy the investors of capital. Or else there has to be public control over corporate management.

3) A third argument against social responsihility of husiness is that if executives are required to invest in social activities, there will be to that extent a reduction of investment in productive activities and for higher pmductivity, Even if companies have

adequate resources to engage in social activities, large scale commitment in that respect is likely to lead to a slower growth in gross national product.

3.7.2 Case for Social Responsibility of Business

If business is recognized as an integral part of the social system, and the broad value question is considered in the context of a social rather than a narrow economic framework, 'the social responsibility of business' is justified on several grounds.

1) Business activity is as much a social activity as an economic activity. The businessman should therefore be responsible for all the consequences of his action, social as well as economic.

2) The market place cannot be a satisfactory arbiter of the social consequences of business activities. Economic considerations which govern market phenomena 'cannot be looked upon in isolation from social considerations or social values.

3) In view of the social consequences of business activities, the influence of business on society cannot be measured only in terms of economic gains or gross national product. The ultimate purpose of business, as of any other institution in society, is to be socially profitable.

4) As business becomes larger, the public is more concerned about its activities because it has a greater impact on society. Business being creature of society, when society's expectations from business change, business should also change its objectives so as to meet the expectations of society. If business does not respond to social demands, the society will force it to do so by legislation.

5) It is in the long-run self-interest of business to be socially responsive. People who have a healthy environment, education and opportunity of development make better employees, customers and neighbours for business than those who are poor, ighorant and oppressed.

3.7.3 Dimensions of Social Responsibilities

The social responsibilities of business include its responsibilities towards owners (shareholders), employees, consumers, government and the community or public at large. Let us examine the nature of responsibilities towards each of these groups.

Shareholders

It is the primary responsibility of every business to see that the owners or shareholders get a fair rate of dividend or fair return on capital invested. This is a legitimate expectation of owners from business. Naturally the expectations have to be reasonable and consistent with the risks associated with the investment. Owners also expect economic and political security of the capital invested. If such security is not ensured, the inevitable consequence is withdrawal of capital and search for alternative channels other than business.

Employees

As regards responsibility towards employees, the major issues governing employer-employee relationship pertain to wages and salaries, superior-subordinate relations and employee welfare. It is the responsibility of management to provide for fair wages to workers based on the principle of adequacy, equity and human dignity. Maintaining harmonious relationship between superiors and subordinates and providing for welfare amenities for employees are also the responsibilities of management. There are specific laws in India governing factory employment under which provision of satisfactory working conditions for safety, health and hygiene, medical facilities, canteen, leave and retirement benefits are obligations cast on the employer. There are other laws providing for the security of workers against the contingencies of sickness, maternity, employment injury and death, provident fund and pension for employees. However, employee welfare cannot be viewed within the narrow limits of legal requirement. Employee welfare is best secured if the management accepts the obligation to secure and maintain a contented work force, and the employees have the opportunity of developing their potential abilities through training and education.

Consumers

Consumer interests are generally expected to be taken care of in a competitive market through forces of demand and supply. However, perfect competition does not actually prevail in all product markets. Consumers are also victims of unfair trade practices and unethical-Conduct of business. Consumer protection has thus been sought through legislation, and' non-government organisations (NGOs) have enlarged their activities for upholding consumer interests. These compulsions are avoidable if management assume the responsibility of satisfying consumer needs and desist from hoarding, profiteering, creating artificial scarcity, as also false, misleading and exaggerated advertisements. Besides, it would be in the long-run interest of business if goods of appropriate standards and quality are available to consumers in adequate quantities and at reasonable prices.

Government

Social responsibility of business towards government requires that (i) business will conduct its affairs as a law-abiding unit, and pay all taxes and other dues honestly, (ii) management will desist from corrupting public servants or the democratic process for selfish ends, and no attempt will be made to secure political support by money or patronage.

Community

Arising out of their social responsihility towards the community and public at large, businessmen are expected to maintain a balance between the needs of business and-the requirements of society. In general business should be so managed as to make the public good become the private good of the enterprise rather than the old doctrine that "what is 'good for the business is good for the society." The social responsibility of business firms should be reflected in their policies with respect to environmental protection, pollution control, conservation of natural resources, rural development, setting up industrial units in the backward regions, employment of the socially handicapped and weaker sections of the community, and providing relief to victims of natural calamities'.

3.8 ECOLOGICAL ISSUES

Eefore examining the ecological issues, let us underline the meaning of the terms 'ecology' and 'ecosystem'. Ecology refers to the inter-relationships between people, the fauna (birds and animals), the flora (plants and trees) and their physical surroundings. Ecosystem is the totality of living and non-living elements in the ecological community interacting with one another and their environment.

The deteriorating quality of environment has been a matter of greater concern over time. It is recognized that environmental protection and ecological balance ate essential to sustain economic development in India in the long-run. The growing threat' to a balanced eco-system is traceable to a number of factors.

(1) The pattern of industrial growth has over the years involved the use of hazardous materials and generation of solid wastes like fly-ash, phosphogypsum and blast furnace slag. These wastes have posed problems of storage, dumping and treatment.

(2) The growth of chemical and petro-chemical industries has also posed serious problems of regulating toxic, flammable and explosive chemicals.

(3) Industrial effluents discharged as waste water into rivers and water courses without treatment are beyond the natural assimilation capacity of rivers. As a consequence, water bodies remain polluted and affect public health. A survey report of the Central Pollution Control Board has meniioned that in 241 class II cities across 17 States about 90 per cent of the water supplied is polluted.

(4) Atmospheric pollution which is mainly in the form of suspended particulate matter is caused by manufacturing and automobile industries emitting thousands of tonnes of pollutants every day in the air, Exhaust fumes' of motor vehicles are more damaging as they are closer to the ground level and high buildings in cities do not permit their dispersal. Coal based thermal power plants also are responsible for atmospheric pollution through emission of gases like sulphur dioxide, nitrogen oxide, etc. This causes acid rains which damage soil vegetation and aquatic life.

(5) Degradation of the environment has been caused further by pressure of population and widespread poverty and led to exploitation of scarce resources which are not easily renewable. Indiscriminate use of forest resources and deforestation have followed growing demand for fuel wood and fodder, over-grazing, over-exploitation for commercial needs, construction of roads and power projects. Reckless deforestation has caused loss of valuable top soil and adversely affected soil productivity.

(6) Pressure on the ecosystems has been equally disturbing, Indiscriminate exploitation of coral reefs has adversely affected the highly productive marine ecosystems. Large areas of mangroves are under biotic pressure as a result of fishing, pollution of water caused by oil spillage from ships and coastal refineries, and discharge of sewerage and industrial effluents. Wetlands which are rich in ,aquatic and bird life, providing food. shelter, spawning and breeding grounds for fishes are also threatened by weed infestation, siltation, chemical and organic pollution, etc.

(7) Mountain ecosystems are also known to be threatened by deforestation causing erosion of top soil thus endangering the security of livelihood of people.

The Issues and Measures to Resolve the Issues

The growing imbalance in ecosystems and degradation of the quality of environment centres around the question of sustainable development. Theinter-link between ecology and development stems from the fact that progress in science and technology has accompanied improvident use of natural resources and led to negative fallout in the process of development. At the same time one cannot deny that millions of people still. suffer from poverty, malnutrition, ill-health, etc. which are traceable to inadequate development. No doubt environmental problems are partly attributable to poverty and under-development, which could be tackled by rapid development. But there are unintended side-effects of the process af development itself which have given rise to many of the environmental problems, which India is facing.

The issues can he resolved if it is realised that environmental factors and ecological imperatives need to he built into the process so as to ensure sustainable development. To meet the challenges the Government has introduced several measures since the eighties in the context of laws passed for conservation of natural resources and abatement of environmental pollution.

The Union Ministry of Environment and Forests, created in 1985, issued a policy statement in June 1992 outlining India's National Conservation Strategy on Environment and Development. The emphasis in the statement was on 'Sustainable Development' as the key element in the Ministry's action plan. The task set was "to ensure sustainable and equitable use of resources for meeting the basic needs of the present and future generations without causing damage to the environment,"

The strategy based on the above policy is an integrated strategy aimed at strengthening the existing programmes of pollution control, ensuing better disposal of solid wastes and hazardous materials, and conserving forests and other bio-diversity rich ecosystems. The National Forest Policy now has the primary objective of ensuring environmental stability and maintenance of ecological balance. It recognises the multiple uses of forests, the rights of local population, the inadvisability of protecting forest resources without their active participation, and the role that forests play in the survival of the poor.

The National Afforestation and Eco-Development Board has been entrusted with the task of regenerating degraded forest areas and ecologically fragile lands besides implementing the eco-development programmes. Likewise, the National Wasteland Development Board has the primary objective of reclaiming wastelands through a massive programme of afforestation with people's participation. Under the National Policy for Abatement of Pollution, Government has stressed the use of economic and policy instruments while introducing pollution control measures. Seventeen environmentally critical and highly polluting industries (*) have been identified by the Union Ministry for special monitoring and enforcement efforts. As a follow-up measure, environmental audit has been made

(*) These industries include sugar, fertiliser, cement, aluminium, fermentation and distillery, petro-chemicals, thermal power, caustic soda, oil refineries, tanneries, copper smelters, zinc smelters, iron and steel, pulp and paper, dye and dye intermediates, pesticides and pharmaceuticals.

compulsory for all industries requiring environmental clearance. For smaller units, schemes have been initiated to assist them in setting up common pollution control facilities.

The strategy of pollution control has also targetted area specific pollution problems and identified 24 critically polluted industrial areas in different parts of the country for special attention. The Government is also pursuing the objective of ushering in clean technologies for waste under the Industrial Pollution Control Project assisted hy the World Bank. Besides, the Bureau of Indian Standards has introduced the "Eco-mark" scheme for certification of products of industries which fulfil prescribed pollution control standards and achieve the required environment friendliness in production, packaging and waste disposal.

Protection of viable habitats for wild life in representative ecosystems is the main strategy adopted for conservation of India's biodiversity, It includes maintenance of National Parks, Wildlife Sanctuaries and Biosphere Reserves for conservation of wildlife species. Towards ecological restoration, schemes have been initiated on captive breeding of plants and commercial utilization of medicinal plants. Government has also initiated measures to promote environmental research, education and training. A number of research institutes have been set up to carry out research on one or more facets of forestry and also to take care of regional needs.

Check Your Progress E

1. What is meant by social responsibility of business?

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 ....

 ....

2. State whether the following statements are True or False.

 i) If business firms engage in social activities it will slow down investments in productive activities, but investment in business does not necessarily mean an improvement in quality of life.

 ii) If business does not respond to social demands, no one will buy the products sold hy it.

 iii) Business is primarily an economic activity hut it is no less a social activity.

 iv) Business activities should he guided by the principle that what is good for the business is also good for society.

 v) It is only with respect to matters which are not covered by legislation that husiness should consider its social responsibilities.

 vi) The question of sustainable development is the central issue in the context of environmental degradation.

 vii) Ecosystem is the totality of living and non-living elements interacting with one another and their environment.

3.9 LET US SUM UP

Over ages, the complexion of Indian society has changed in many ways. A pluralistic society has evolved from the monistic society of the past. The pluralistic society is characterized by numerous groups organized to serve economic, social, political, religious and professional interests of the members. The nature and forms of business enterprises have also changed over time. While business is influenced by different interest groups and institutions, it also exerts its influence on other institutions. Over time, far reaching changes have also taken place in the social institutions. Traditional occupations based on hereditary skills and linked with castes have lost their significance. Spread of educational opportunities along with improvement in transport and communications have resulted in greater mobility of people. The institution of joint family is gradually breaking down, Life styles and norms of consumption have also changed with urbanisation and changing pattern of occupations.

Underlying the changes in social institutions there has occurred demographic changes. India's demographic profile shows that while death rate has continued to decline, birth rate remains relatively high, which is reflected in the high growth rate of population. Thus India would appear to be in the second stage of demographic transition. However beginning with the 70's one may consider the stage set for transition to the third stage of demographic transition, with a downward trend of birth rate, A high density of population is another feature of India's demographic profile. This is indicative of a high burden on land which is likely to increase further with additions to population. India continues to be the second largest populated country in the world next to China.

The cultural changes which have taken place and are still continuing to change are reflected in changes in people's consumption pattern, tastes and preferences and habits and customs. While religion as an element of culture has provided strong emotional bonds among people, religious orthodoxy has made people sectarian in outlook, dogmatic and intolerant of other's views. In this context, secularism is regarded as a valued aspect of Indian culture. During the last fifty years, people in India have imbibed modern, western values and emphasis has shifted from religious and social values to economic and political values.

Advancement of technology has been one of the most important factors causing far reaching social changes. Technology has often had a multiplier effect. Technological progress has led to higher productivity and improved quality of products. It has enabled faster communication of knowledge and information, and brought about enormous saving in time and energy. However, technological changes have also brought about several socially undesirable consequences like spread of consumerism, subordination of moral values to materialistic values and deterioration of human values.

Changing value system is another dimension of social change in India. Growing awareness of the importance of economic values and pursuit of material gain are increasingly reflected in the conduct of people. Correspondingly, social and religious values have lost importance in the value system, Pursuit of self-interest and individualism as cherished values have become more important while erosion of moral values seems to threaten the social fabric. Business values are known to influence social values in no small degree. With the change in social values and with a view to bringing about a change in business values, Government has enacted legislation and large business corporations are increasingly responding to the demand for social responsibilities.

Social responsibility of business refers to the obligation of business firms to adopt policies and lines of action which are desirable in terms of the expectations and interests to society. The social responsibilities of business include its responsibilities towards owners, employes, consumers government and the community or public at large.

Ecological issues related with conservation of natural resources, environmental protection and maintenance of ecological balance centre around the question of sustainable development. The growing threat to a balanced ecosystem is traceable to a'number of factors like technological progress, industrial growth, pressure of population and widespread poverty. Even though environmental problems are partly attributable to poverty and under-development of the economy, there are also unintended side-effects of the process of development itself which have given rise to many of the environmental problems in India. Several measures have been adopted by the Government to resolve some of the major issues.

3.10 KEY WORDS

Culture : Values, norms, artifacts and accepted behaviour of people; totality of behaviour consisting of learned responses.

Demographic Transition (theory of) : Rate of growth of population varying with the stage of economic development.

Dependency Ratio : average number of dependents on an' earning person.

Ecology : Inter-relationships between people, fauna, flora and their **physical surroundings.**

Economic Value : Desirability of material gain and practicability of action.

Eco-system : The totality of living and non-living elements in the ecological community interacting with one another and their environment.

Monistic society : Society in which human activities were undertaken in the context of a single social institution, the village community.

Political value : Desirability of acquisition of power.

Pluralistic society : Society in which there are numerous interest groups in the social system.

Religious value : Desirability of morality and righteous conduct.

Sex-ratio : ratio of women to men.

Social responsibilit : Obligation to meet social needs.

Social value : Desirability of love of people and equality.

Utilitarian value : Desirability of maximum good for the maximum number.

Values : Normative views held by people of what is good and desirable.

Value System : Set of values with priority-rating based on their relative importance.

3.11 ANSWERS TO CHECK YOUR PROGRESS

A. 2	i) True,	ii) False,	iii) True,	iv) True,	v) False
C. 4.	i) True,	ii) True,	iii) True,	iv) False	
E. 2.	i) True,	ii) False,	iii) True,	iv) False,	
	v) False,	vi) True,	vii) True		

3.12 TERMINAL QUESTIONS

1. Discuss the nature of institutional changes in Indian society since independence.
2. Describe the impact of changing technology on the social system, Do you agree with the view that technological progress is not an unmixed blessing ? Explain.
3. Give. an outline of the theory of demographic transition. What is its relevance in the Indian context?
4. Briefly explain the social implications of the rate of growth of population, high density. life expectancy and rural-urban distribution of population in India.
5. Identify the elements of culture which, have undergone changes in recent times and affected the social system in India. Explain them briefly.
6. Describe the nature and causes of changes in value system and the extent to which they have contributed to progressive ideas.
7. Aualyse the rationale of business assuming social responsibilities keeping in view the case against it.
8. Discuss the nature of social responsibilities of business towards employees and the community.
9. How are ecological issues relevant'to business environment in India?
10. How is Government policy directed towards meeting the question of environmental degradation and sustainable development?

Note: These questions will help you to understand the Unit better. Try to write answers for them, but do not send your answers to the University, These are for your practice only.

SOME USEFUL BOOKS

Francis Cherunilam, *Business Environment*, Himalaya Publishing House, Mumbai.

George Steiner, *Business and Society*, Macmillan, New York.

Indira Gandhi National Open University, Course Materials — *MS-3 : Economic and Social Environment.*

Tandon, B.B. & Tandon, K.K., *Indian Economy*, Tata McGraw Hill, New Delhi.

UNIT 4 STRUCTURE OF INDIAN ECONOMY

Structure

4.0 OBJECTIVES

Atter studying this unit, you should be able to:

- explain the meaning of real'income and analyse the trends in real income
- explain the meaning of economic growth
- analyse the trend in the rate of growth of Indian economy
- explain the meaning of economic development
- state the goals of development
- analyse: the trends in per capita real income in India
- explain the extent of poverty and the extent of inequalities in India
- explain the trend in work participation rates in India
- analyse the changes in occupational structure in India
- outline the main features of the Indian economic system in terms of ownership and organisation

4.1 INTRODUCTION

The term economy refers to the production units and economic activities of those who are engaged in these production units. The Indian economy, therefore, refers to the farm, factories, shops, offices, government departments, schools, colleges, service centres, charitable institutions, and for that matter every individual and institution engaged in production of goods and services. This is irrespective of whether the production unit is big or small, privately owned or government owned, producing a good or a service. This is also irrespective of whether goods or services so produced arc meant for sale, for self-consumption or for free distribution.

A production unit is nothing hut an association of the owners of four resources who provide land, labour, capital and entrepereneurship and who join hands to produce a good or a service. The collective contribution of the owners of the four resources is termed as 'value added'. These owners share this value added in the form of wages, rent, interest and profits. The sum total of such remuneration accruing to the residents of India is India's national income.

National income reveals a lot about the structure of an economy relevant for business environment. Its volume indicates how much rich or poor a country is. Its rate of change measures the rate of economic growth. Its spread indicates the equitable distribution of income among different economic and social groups in the country, Its composition reveals the demand structure or the preferences of the people.

How much national income is earned and how it is distributed is important. But how the national income earned is also equally important. You know that national income is the collective effort of the owners of resources, i.e. the four factors of production. Naturally, the quality of these resources becomes an important determinant of national income. Also important are the technology employed, infrastructure, productivity, and so on.

Among the resources labour force is the most fundamental aspect of the structure of an economy. In fact it is the beginning. and the end of all economic activities. The natural desire to live and live comfortably drives the human being to work to support themselves and their dependents. As such the composition of working force in terms of age, sex, occupations, skill, education, etc. is an important determinant of the business environment of the country.

Besides the above there are many other economic and non-economic determinants of business environment of a country. Structure of international trade, financial institutions, transport facilities, educational institutions, market organisations, housing etc. are some exaniples of economic determinants. Political stability, social structure, attitudes of the people, customs, etc are some examples of non-economic determinants. So there are. numerous structural aspects which determine the economic and business environment of a country. However, the scope of this lesson is limited to national income, economic growth, economic development, labour force, occupational structure and pattern of ownership and organisation of production activity.

4.2 TRENDS IN NATIONAL INCOME

The word "national income" means remuneration accruing to the owners of resources in the form of wages, salaries, rent, interest and profits. Therefore national income of India is the sum total of factor incomes accruing to the Indian residents from their participation in' production activity whether within India or abroad.

4.2.1 Meaning of Real National Income

To what use we can put the money income we earn ? Obviously we use income to buy goods and services. Money income represents command over goods and services. If a person's income is Rs, 50,000 per year it means that he can acquire goods and services worth Rs 50,000 during the year. We can elaborate this point by taking a highly simplified example, Suppose only one good x is produced in the economy. Also suppose that the price of the good in the year in question is Rs. 50 per unit. The maximum quantity a

person can purchase from Rs. 50,000 is 1000 (= 50,000 / 50). This leads to the distinction between money income and real income. Rs. 50,000 is the money income while 1000 x is the real income. Real income is simply what one can buy from money income.

What matters to an individual is not how much money he earns but the amount of goods and services he can get from what he earns. So, what matters is the real income and not the money income. What is true about an individual is also true about a nation. For comparing the national income over a time period it is the real national income which is relevant.

The techincal measure of real national income is known as National Income at Constant Prices (NICOP). Money national income is termed as National Income at Current Prices (NICUP). We can explain the significance of this distinction with the help of an example. The example is summed up in the following table (Table 4.1)

Table 4.1 : Money income and Real Income

Year	Money Income	Price of X (Rs. per unit)	Amount of X that can be bought with money income
1991	30,000	40	750
1996	50,000	50	1000

In the above example, between 1991 and 1996 money income increased by 66 percent while real income (column 4) increased by 33 percent. The nation is better off by 33 percent and not 66 percent. It is because the nation is getting 33 % more goods and services over the five year period. So it is NICOP which reveals which forms the basis of comparison over a period of time.

4.2.2 Trends in Real National Income

We have explained above the meaning of national income and National Income at Constant Prices (NICOP). The understanding of these two concepts should be enough for you lo effectively interpret the trends in national income of India. Remember that NICOP is always measured with reference to the price level of a particular and a carefully chosen year. Such an year is called base year. The present base year in Indian estimates of NICOP is the year 1980-81, There is nothing like a permanent base year. In India the base year is changed after every ten years. Trends in national income of India arc given in Table 4.2

Table 4.2,: National Income of India : 1950-51 to 1995-96
(Net National Product at Factor Cost)

Year	Net National Product at Current Prices				Net National Product at Constant Prices (1980-81 prices)			
	Total (Rs. Crores)	Annual Growth Rate	Per Capita (Rs.)	Annual Growth Rate	Total (Rs. Crores)	Annual Growth Rate	Per capita (Rs.)	Annual Growth Rate
1	2	3	4	5	6	7	8	9
1950-51	8574	–	238.8	–	40554	–	1126.9	–
1951-52	9034	5.4	247.5	3.6	41443	2.4	1135.4	0.8
1952-53	8882	–1.7	238.8	–3.5	42613	2.8	1145.5	0.9
1953-54	9696	9.2	255.8	–8.6	45292	6.3	1195.1	4.3
1954-55	9023	–6.9	233.8	–8.6	47111	4.0	1220.5	2.1
1955-56	9161	1.5	233.1	–0.3	48288	2.5	1228.7	0.7
1956-57	10972	19.8	273.6	17.4	50955	5.5	1270.7	3.4
1957-58	11177	1.9	273.3	–0.1	50051	–1.8	1223.7	–3.7
1958-59	12459	11.5	298.1	9.1	53869	7.6	1288.7	5.3
1959-60	13035	4.6	306.0	2.7	54775	1.7	1285.8	–0.2

	2	3	4	5	6	7	8	9
1960-61	14242	9.3	328.2	7.3	58602	7.0	1350.3	5.0
1961-62	14946	4.9	336.6	2.6	60168	2.7	1355.1	0.4
1962-63	15947	6.7	351.3	4.4	61165	1.7	1347.2	-0.6
1963-64	18258	14.5	393.6	12.0	64216	5.0	1384.0	2.7
1964-65	21373	17.1	450.9	14.6	68942	7.4	1454.5	5.1
1965-66	22247	4.1	458.7	1.7	65734	–4.7	1355.3	–6.8
1966-67	25215	13.3	509.4	11.1	66089	0.5	1335.1	–1.5
1967-68	29745	18.0	587.8	15.4	71519	8.2	1413.4	5.9
1968-69	31311	5.3	604.5	2.8	73285	2.5	1414.8	0.1
1969-70	34421	9.9	650.7	7.6	78177	6.7	1477.8	4.5
1970-71	36503	6.0	674.7	3.7	82211	5.2	1419.6	2.8
1971-72	38717	6.1	698.9	3.6	82675	0.6	1492.3	–1.8
1972-73	42510	9.8	749.7	7.3	81991	–0.8	1446.0	–3.1
1973-74	52362	23.2	902.8	20.4	86010	4.9	1482.9	2.6
1974-75	61290	17.1	1033.6	14.5	87116	1.3	1469.1	–0.9
1975-76	64623	5.4	1064.6	3.0	95433	9.5	1572.5	7.0
1976-77	69523	7.6	1121.3	5.3	96253	0.9	1552.5	–1.3
1977-78	79749	14.7	1257.9	12.2	103670	7.7	1635.2	5.3
1978-79	85298	7.0	1316.3	4.6	109466	5.6	1689.3	3.3
1979-80	92324	8.2	1390.4	5.6	102937	–6.0	1550.3	–8.2
1980-81	110685	19.9	1630.1	17.2	110685	7.5	1630.1	5.1
1981-82	128797	16.4	1861.2	14.2	117140	5.8	1692.8	3.8
1982-83	141875	10.2	2003.9	7.7	149704	2.2	1690.7	–0.1
1983-84	166550	17.4	2303.6	15.0	129392	8.1	1789.7	5.9
1984-85	185018	11.1	2503.6	8.7	133808	3.4	1810.7	1.2
1985-86	206133	11.4	2730.2	9.1	139025	3.9	1841.4	1.7
1986-87	228402	10.8	2962.4	8.5	144242	3.8	1870.8	1.6
1987-88	258891	13.3	3285.4	10.9	149787	3.8	1900.9	1.6
1988-89	309289	19.5	3842.1	16.9	165750	10.7	2059.0	8.3
1989-90	357285	15.5	4346.5	13.1	177315	7.0	2157.1	4.8
1990-91	418074	17.0	4983.0	14.6	186446	5.1	2222.2	3.0
1991-92	479612	14.7	5602.9	12.4	186191	–0.1	2175.1	–2.1
1992-93	546023	13.8	6261.7	11.8	195630	5.1	2243.5	3.1
1993-94	637996	16.3	7184.6	14.7	207264	5.9	2334.1	4.0
1994-95	748652	17.3	8281.5	15.3	221406	6.8	2449.2	4.9
1995-96	857570	14.5	9321.4	12.6	236738	6.9	2573.8	5.1

The figures of national income for the period 1950-51 to 1995-96, both at current and constant prices, (i.e. both money income and real income) are given in Table 4.2. This table gives NICUP and NICOP and the rate of change over the proceeding year. We have already said that the comparison overtime of NICUP is not meaningful because it contains an element of price change. Take for example the year 1973-74. During the year NICUP increased hy 23.2% while NICOP increased by only 4.9%. The difference represents price increase. Take another year 1991-92 during which NICUP increased by 14.7% while NICOP fell by 0.1%. It means that entire increase in NICUP during the year was on account of price increase only. It also means that there was no increase in overall physical output in the country. You can locate many such years, like 1965-66, 1979-80, which record increase in NICUP but decrease in NICOP.,On account of this reason only a comparison of NICOP figures makes sense.

Column 7 (Table 4.2) gives the rate of growth of NICOP over the previous year. We find that this rate of growth has been fluctuating. It ranges from as high a figure as of 10.7% in 1988-89 to a negative growth of 4.7 in 1965-66. Such wide fluctuations are due to agriculture being the main occupation of the people of India all these years. The agricultural output is subject to fluctuations due to heavy dependence on rains. Also the performance of industry is linked to the performance of agriculture because agriculture is the main source of raw materials as well as demand for industrial products.

To understand the long term trend in national income it is always better to study the average change over a bunch of years rather than over each year, Let us make a bunch of

10 years and calculate the simple average of the rate of growth of NICOP during each bunch. The calculations so derived are given in Table 4.3.

Based on the data contained in Tables 4.2 and 4.3, we observe that NICOP is rising over the 45 year period with exceptions of setbacks during a few years here and there. Second, the average annual increase over each decade has been between 3 to 5 per cent. The increase was highest (5.4 per cent) during the decade 1981-82 to 1990-91. Third, the average annual rate of increase over the 45 year period is around 4 per cent.

Table 4.3 : Trends in National Income at Constant Prices (1980-81 prices) in India during 1951-52 to 1995-96

Period	Simple average of annual change	
	National Income at Constant Prices	Per capita NICOP
1	2	3
1951-52 to 1960-61	3.8	1.8
1961-62 to 1970-71	3.5	1.3
1971-72 to 1980-81	3.1	0.9
1981-82 to 1990-91	5.4	3.2
1991-92 to 1995-96	4.9	3.0
1951-52 to 1995-96	4.0	1.9

Check Your Progress A

1, Choose the correct alternative :

a) National income corrected for price change is :
   i) Money national income
   ii) Real national income
   iii) Net national income
   (iv) None of the above..

b) The average annual change in national income at constant prices in India during 1951-52 to 1995-96 is
   i) 4.0 per cent
   ii) 1.9 per cent
   iii) 4.9 per cent
   iv) 0.9 per cent

c) The chgnge in total physical production in a country is indicated by :
   i) Per capita income at current prices
   ii) National income at current prices
   iii) Per capita income at constant prices
   iv) National income at constant prices

2. State briefly few'observations regarding the trend in real income in India since 1951-52,

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4.3 ECONOMIC GROWTH

4.3.1 Meaning of Economic Growth

In the most fundamental sense economic growth means rise in full employment real output,

or, national income at constant prices. It is a measure of the nation's capacity to produce. Economic growth in this sense represents growth of resources in a country. In practical usage, however, economic growth is associated with the rate of change in national income at constant prices (NICOP) whether at full employment level or otherwise. The rate at which NICOP changes during the year is taken to be the rate of growth in that year. As such the growth means rise in real output or national income. For example, the annual increase of 5.4 percent in NICOP during the eighties (Table 4.3) means 5.4 percent increase in physical production of goods and services. It is in this sense we will talk about economic growth of India.

4.3.2 Trends in the Rate of Growth

Column 2 of Table 4.3 gives the annual rate of growth (of national income at constant prices) of the Indian economy during each decade beginning 1951-52. The rate of growth was around 3 percent and falling marginally over the first three decades ending 1980-81. During the last 15 years it is around 5 percent. This shows that the Indian economy is picking up over the last 15 years.

India has adopted the path of planning to promote economic growth. The period unit of plan is five years. So far eight five years plans have been completed with a few yearly plans in between. So it is better to compare the rate of econolnic growth over each plan period. Such rates are given in Table 4.4.

Table : 4.4 Annual Compound Growth Rates During Five Year Plans (1951-1996)

Plan	Period	Compound Rate of Growth	
		National income at constant prices	Per capita income at constant prices
First Plan	1951-56	3.6	1.7
Second Plan	1956-61	3.9	1.9
Third Plan	1961-66	2.3	0.1
Three Annual Plans	1966-69	3.7	1.4
Fourth Plan	1969-74	3.3	0.9
Fifth Plan	1974-79	4.9	2.6
Sixth Plan	1979-80	-4.0	-8.2
Seventh Pla	1980-85	5.4	3.2
n	1985-90	5.8	3.6
Eighth Plan	1990-92	2.5	0.5
Eighth Plan	1992-96 (Four Years)	6.2	4.3

It is clear from the above table that the Indian economy is picking up speed from the Fifth Plan onwards and maintaining a rate of grow of about 5% during each subsequent plan. The rate is highest during eighth plan i.e. 6.2 per cent (for the first four years). Eighth Plan is also the period of economic reforms and economic liberalization including liberalization of imports, movement of foreign exchange resources, foreign capital, privatisation, etc. All these measures have started showing their impact on the rate of economic growth. These reforms have definitely contributed to the business environment. The policy of direct and indirect protection to the Indian industries is gradually being relaxed. The degree of competition is increasing with inflow of foreign enterprises in India, The intention is to make Indian industries stand on their own and try to compete in international market. The mobility of resources and products of India vis-a-vis the rest of the world is increasing, In brief the Indian economy is opening up for the last 5-6 years and its results are reflected in India's rate of economic growth over the recent years. The rate of growth in 1995-96 was 6.9 per cent (Table 4.2).

Economic growth is a consequence of quantity and quality of resources. The quality of resources is reflected in factors like the technology used, scale of production, degree of

specialization, skilled labour, socio cultural institutions etc. On the other hand the consequences of economic growth are reflected in positive changes in standard of living, quality of life, distribution of income, quality of resources, pace of industrialization, institution, attitudes, values and so on. When, besides the rate of growth of NICOP, we talk about other qualitative changes in an economy we arc in fact referring to 'economic development'. Let us talk about economic development, as distinguished from economic growth, in the following paragraphs .

4.4 ECONOMIC DEVELOPMENT

4.4.1 Meaning of Economic Development

There is no unique definition of economic development. Various authors in the field of economics came out with different definitions of economic development. Still there is a common thinking in the various views about what economic development means. This common thinking is beautifully summed up hy Meier when he defines economic development as **"growth plus change".** Growth here refers to what we have already discussed above i.e. rise in national income at constant prices. The word "change" here refers to the qualitative changes in the economy. All definitions would agree that economic development means change but they may not agree the hroad contents of this change. Still there are certain components of change on which the possibility of disagreement is minimum. For example, no one will disagree that rise in the general standard of living of the people means economic development. All would agree that increase in productivity, knowledge etc. and reduction in unemployment is economic developinent. No one will dispute the removal of poverty is the goal of development. On the other hand, there may be disagreement in economic, social, political and cultural institutions. What type of change in these institutions constitutes economic development ? There cannot be any single yard stick for all countries because of vast ,differences in resources, economic conditions, cultural heritage, social organization, political traditions, etc.

Now let us know what constitutes economic development and what not. The purpose is to pick up certain widely accepted goals of development and review them in the context of Indian economy. These accepted goals have emerged from the experiences of the countries who have gone through the process of development.

4.4.2 Goals of Development

The primary goal of develgpment remains to he the increase in per capita real national income of a country over a long period of time. What is emphasized in the goal is 'per capita' and not total national income. If the rate of increase in population is faster than the rate of increase in total national income, the living standards instead of rising may fall. This cannot be considered economic development. So rate of growth of real national income (NICOP) corrected for population change is a better indicator of economic development, The goal also emphasizes increase in real per capita income over 'long period' instead of short period . It is because of the fact that only a sustained increase in real per capita national income can he considered as economic development. The rise in real national income over one or two 'or a few years can be the result of some temporary happenings or efforts. Sustaining development over longer periods'is a difficult task. According to Meier the underlying upward trend over two or three decades is the stronger indicator of development.

Besides the primary goal of increasing per capita real income there are many other sub goals. Some of these are: **reducing inequalities in the distribution of income, eliminating poverty, ensuring certain minimum level of consumption, reducing unemployment, reducing regional disparities, increasing modern knowledge, removal of undesirable conditions in social system** and many others. All these varied requirements of development make it impossible to delimit the dimensions of economic development for all countries. The dimensions will vary at different times and for different countries.

The primary goal of raising per capita real income is the common goal of all countries. The sub goals may vary from country' to country. Most of the sub goals listed above are relevant to the Indian economy. In view of the limited statistical data it may be difficult to

assess the achievements on these fronts. What is available at present are certain broad indicators of economic development. These indicators are listed in Table 4.7. The detailed data on the primary goals of raising per capita real income are already given in Tables 4.2, 4.3 and 4.4.

4.4.3 Trends in Per Capita Real Income

Let us record our observations about the goal of raising per capita real income or what is technically called National Income at Constant Prices (NICOP). Table 4.2 gives the rate of change of NICOP on yearly basis. **First,** the annual rate of change in per capita NICOP has been lower by nearly 2 percentage points as compared to total NICOP. It implies that population has been increasing at the rate of 2 per cent every year and responsible for slow rate of rise of per capita income. **Second,** there have been wide fluctuations in the rate of growth of per capita income ranging from an increase of as high as 8.3% in 1988-89 to a fall of 8.2% in 1979-80. There are quite a few years during which per capita income actually fell. These fluctuations are on account of the fluctuations in agricultural output which has been a main component of national income. **Third,** average annual rate of growth of per capita income over ten years (as shown in Table 4.3) evens out these fluctuations a great deal and presents a more realistic picture of change in per capita income.. During the first three decades beginning 1951-52, the rate of growth of per, capita income is quite low ranging between 1-2%. Only during the last 15 years (1981-1996) it has shown some promise when it has crossed 3% mark. The plan wise data are given in Table 4.4. The first four years of the 8th plan (1992-97) records the highest annual rate of growth of per capita income at over 4%. Therefore, the recent trends show a promising picture of business environment.

4.4.4. Trends in Poverty

We have already pointed out that economic development is not limited to only rise in per capita real income. It also means many other things like removal of poverty, reducing inequalities, raising standard of living, raising productivity, and many other qualitative achievements. Out of these, attack on poverty has been the most common goal of economic development.

There is a concept called **poverty line.** This line is determined on the basis of recommended nutritional requirements or on the basis of per capita monthly expenditure. Those who do not meet the recommended nutritional requirements or the minimum per capita monthly expenditure are considered poor or below the poverty line. There is no regular flow of data on the poverty line. There are many expert studies out of which the most recent one is by the Lakdawala Expert Group and accepted by the Planning Commission. The study is only for a limited number of years. Out of these we take 1973-74 and 1993-94 for comparisdli.

Table 45 : Population below the Poverty line in India

Year	No. of Persons (Crores)	Percent of total population
1973-74	32.13	55
1993-94	32.03	36

The above data show that in relative terms the poverty declined from 55% to 36% over the 20 year period. But in absolute terms the number of persons below the poverty are added to the list of poor as many cross the poverty line on account of economic development. It also means that rise in population is an important contributory factor to poverty and that development efforts have not been sufficient to outdo this factor. Still nearly one out of three persons is below the poverty line.

4.4.5 Trends in Inequalities in Income

There is no regular flow of data about the inequality in the distribution of income. However we can draw some conclusions on the basis of whatever little data are available. The following data (Table 4.6) are based on two studies, by Mahalnobis for the year 1952-53 and by the World Bank for the year 1992.

Table 4.6 : Distribution of Income in India

Per cent of Population	Per cent of Income	
	1952-53 (Mahalnobis)	1992 (World Bank)
Lowest 20%	7.5	8.5
Highest 20%	--	42.4
Highest 10%	24.0	28.4

Clearly there is not much change in the extent of inequalities in India. Economic development has made little impact on reduction in income inequalities. In fact if we take the highest 10% income earners as the basis we find some increase in inequalities.

4.4.6 Other Indicators of Development

We know that economic development of a country is indicated by a large number of variables. We have already made some observations regarding per capita income, poverty and inequality. Some other indicators of economic development relating to human resources, medical facilities, consumption and productivity arc presented in Table 4.7.

Table 4.7 : Indicators of Economic Development of India

	1950-51	1960-61	1970-71	1980-81	1990-91	1995-96
Human Resources						
Life Expectancy (Years)	32.0	41.0	46.0	50.0	59.0	--
Death rate (per 1000)	27.0	23.0	15.0	10.0	10.0	--
Literacy rate (per 100)	18.0	28.0	34.0	44.0	52.0	--
Medical Facilities						
Registered Medical Practitioners (per Lakh)	17.0	19.0	28.0	39.0	47.0	--
Hospital Beds (per Lakh persons)	32.0	52.0	64.0	83.0	96.0	--
Consumption (Net availability per person)						
Cereals (gms) (per day)	334.0	400.0	418.0	418.0	469.0	464.0
Pulses (gms) (per day)	61.0	69.0	51.0	38.0	42.0	34.0
Sugar (Kg) (per year)	--	4.8	7.4	7.3	12.1	14.1
Edible Oil (Kg) (per year)	--	3.2	3.5	3.8	5.5	7.2
Cloth (meters) (per year)	--	15.0	15.6	17.3	24.1	24.0
Electricity (Domestic) KWH (per year)	--	34.	70.	13.5	38.2	53.0
Productivity (per hectare)						
Foodgrains (Kg)	--	710.0	872.0	1023.0	1380.0	1499.0
Sugarcane (Tons)	--	46	48.0	58.0	65.0	68.0
Cotton (Kg)	--	125	106.0	152.0	225.0	246.

Source: Economic Survey 1996-97, Government of India.

The above data clearly indicate that economic development is taking place in India. Whether it is at desirable rate or not can be ascertained only by comparing the

performance with other countries. Also economic development is not the function of above variables alone. There are many political, sociological, cultural changes which indicate development but cannot be expressed in numerical terms.

Check Your Progress B

1. Choose the correct alternative :

   a) Rate of economic growth in India is measured in terms of :

      i) Rise in full employment real output.

      ii) Growth of resources.

      iii) Rise in national income at constant prices.

      iv) Rise in national income at current prices.

   b) Among the first seven five year plans the highest rate of growth was experienced during

      i) First Plan

      ii) Second Plan

      iii) Sixth Plan

      iv) Seventh Plan

   c) The primary goal of economic development is

      i) Increase in money national income

      ii) Increase in real national income

      iii) Increase in per capita money income

      iv) Increase in per capita real national income

   (d) Economic development of a country is expressed in terms of

      i) Only quantitative changes

      ii) Only qualitative changes

      iii) Both quantitative and qualitative changes

      iv) None of the above

2. Write a note on goals of development of a country.

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3. What is poverty line?

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4.5 GROWTH IN LABOUR FORCE

Labour force, or human resource, plays two fold role in economic development. It is (a) a factor of production and (h) consumer. It thus contributes both to the demand and supply aspects of production. The quantity of labour force depends on demographic composition. Its quality depends on health, nutrition, literacy, education and experience.

Normally, population in a particular age group is treated as the potential labour force. In India this age group is 15-60 years. But it is not necessary that all in that age group are working. It depends on sex composition, willingness to work and availability of work. Normally not all women are gainfully employed. Many of them are fully occupied with their household work mostly as a social compulsion. As far as willingness to work is concerned we can safely presume that nearly all able bodied persons are willing to work. But whether actually one gets gainfully employed or not depends on the business environment in the country.

Changes in two aspects ,of labour force indicate economic development in a country. First, are more women participating in work? Second, is percentage of working force in non-agricultural occupations increasing or not? Let us analyse the trends in these two aspects in the case of Indian economy.

4.5.1 Female Work Participation Rate

The trend in female work participation rates is summed up in Table 4.8. The trend indicates that the proportion of female workers to total female population is continously increasing over the last three censuses. It was 14.2% in 1971, 19.7% in 1981 and 22.7% in 1991. In absolute terms the number of female workers increased from 3.7 crores in 1971 to 6.5 crores in 1981 and to 9.1 crores in 1991. Although the increase in the number of female workers is quite impressive, it is much lower than the number of male workers. This increase in the proportion of female workers is a sign of qualitative economic development of the country.

Table 4.8 : Work Participation Rates in India (1971-1991)

	1971	1981	1991
		Population (Crores)	
Males	28.4	35.3	43.4
Females	26.4	33.0	40.3
Tatal	54.8	68.3	83.7
		Workers (Crores)	
Males	15.0	18.6	22.4
Females	3.7	6.5	9.1
Total	18.7	25.1	31.5
		Percentage of workers to population	
Mabs	52.7	52.6	51.5
Females	14.2	19.7	33.7
Total	34.2	36.7	37.6

4.5.2 Occupational Structure : Agriculture vs Non-Agriculture

Generally, when proportion of working force in non-agricultural occupations increases it is taken as positive sign of economic development. In other words economic development is equated with industrialization. The trend in the proportion of working force in the primary, secondary and tertiary sectors in India is summed up in Table 4.9.

Table 4.9 : Percentage Distribution of Working Force in India (1951-1991)

Sectors	1951	1961	1971	1981	1991
Agriculture	72	72	72	69	69
Industry	11	12	11	13	13
Services	17	16	17	18	20
Total	100	100	100	100	100

The data reveal that the proportions remained constant till 1971. It has started going in favour of non-agricultural occupations after 1971, but only marginally. This indicates development hut slow pace of development, It may he on account of twp reasons. **First,** the productivity in agriculture is low so that a large proportion of working force is still required in agriculture to meet the food and non-food demands of the growing population. **Second,** there is limited expansion of employment opportunities in 110x1-agricultural sectors forcing the work force to continue to stick to agriculture. The over all picture on employment front at present-(1997) is not very encouraging. Employment opportunities are not expanding at the required rate. Unemployment is increasing and this is not a positive sign of development.

Check Your Progress C

1. What are the two ways in which labour force contributes to economic development?

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2. What are the two aspects of change in labour force which indicate economic development?

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4.6 'ECONOMICSYSTEM: PATTERN OF OWNERSHIP AND ORGANISATION

4.6.1 India - A Mixed Economy

The ownership of the means of production, in any economy, rests either in the hands of private individual or in the hands of government or partly in the hands of both. When the production units are by and large in the hands of the private individuals, the economy is termed as a capitalist economy. When these are mostly in the hands of the state, i.e. the government, the economy is termed as a socialist economy. U.K., U.S.A., Germany, France are some examples of capitalist economies. China and North Korea are some examples of socialist economies.

When both, private individuals and government, hold significant proportion of production units' the economy is termed as a mixed economy: In the real world, the major proportion of production activity in a mixed economy is carried out by the private sector and a smaller hut significant proportion hy the government. As such it is sometimes referred to as a mixed capitalist economy, Most of the developing countries of Asia and other regions of the world are of this type. India is also a mixed economy.

Ownership Patterns

In a **mixed** economy three possible ownership patterns emerge. Production units are owned by 1) private individuals, 2) government and 3) jointly by both. The three respectively referred to as 1) private, 2) public and 3) joint sectors. In India there is another sector called the 'cooperative sector'. This is essentially private sector. In this pattern private individuals pool their productive resources to take advantage of carrying out production on a bigger scale, Government encourages this sector by providing them with certain facilities and concessions. As such the Indian economic system is characterised by the presence of private, public, joint and cooperative sectors.

Organisational Pattern

The pattern is broadly classified into 'corporale' and 'non-corporate' types. Corporate units are organised in a manner laid down under some law enacted specially for this purpose. In India, the corporate production units are set up in accordance with the provisions of the Indian Companies Act, 1956. Such units undertake production on large scale and may be private, public or joint units. Nan-corporate units are not covered by this Act and undertake production on a smaller scale. It includes small scale industries, cottage industries and all other small business. In India the entire agricultural production activity is of this type. In the rural areas nearly the entire production activity is of non-corporate type. In the urban areas it is partly corporate and partly, hut major part, non-corporate. All small industrial units, shops, service centres, etc. are of this type.

The corporate and the non-corporate business activities are also sometimes referred to as 'organised' and 'unorganised' activities respeclively. The organised sector is legally required to publish its activity data in the form of annual reports. The unorganised sector is under no such compulsion. As such the data about the organised sector is more conveniently available than about the unorganised sector.

Let us now outline the features of the above sectors in the Indian economy. When India undertook its experiment with planning in the year 1951, the picture of future India in the minds of planners was that of a mixed economy. Accordingly as the Indian economy proceeded with its planning experiment it started emerging along with the public, Joint anti the cooperalive sectors. Private sector already existed.

The present Indian structure 'is essentially the outcome of the Industrial Policy Resolution of 1948 in which definite roles were assigned to the public and privale sectors. For some industries the responsibilily of development was entrusted only to the public sector, for some only Io the private sector, and Tor some to both the private and public sectors. With planning experiences the roles were modified from time Io time in the Industrial Policy Resolutions that followed in the years 1956, 1977, 1980 and 1990. The Industrial Policy of 1991 marked a definite departure. I1 limited the role of public sector and advocated the expansion of the role of the private sector. You will study in detail about the New Industrial Policy in Unit 8.

4.6.2 Public Sector

Production.units owned by government are called public sector units. These are broadly of three types:

1) Those producing administrative, social, community and personal services (i.e. general services)
2) Departmental commercial undertakings (DCU)
3) Non-departmental commercial undertakings (NDCU)

'General services' include fiscal services like collection of taxes; administrative services like police,.defence, law and justice, external affairs, etc; social and community services like education, health, housing, transport, etc. Such services are normally supplied free or at a price which is below the cost. The production of such services belongs to the non-corporate sector.

DCUs are also non-corporate production units hut run on commercial lines. These are owned and managed by the government departments, Railways. Delhi Milk Scheme, Posts and Telegraphs are some examples. DCUs **fix** the price of what they produce on commercial basis.

NDCUs are government companies and statutory corporations. **A** government company is one in which 51% or more of paid up capital is held by some government department. A statutory corporalion is one which is set up under some special enactment of parliament or state legislature. All nationalised banks, Life Insurance Corporation, Oil and Natmal Gas Commission, Food Corporation of India ate some examples.

Public sector as producer of general services and the DCUs are present hoth in rural and urban areas but more prominently in urban areas. Public sector, in the form of **NDCU,** is present largely in urban areas and only to some extent in the rural areas in the form of some scattered branches in these areas.

As far as the central government undertakings are concerned there were 243 units in the year 1996. The number does not include banks, financial institutions and departmental enterprises. (So the actual number of public sector units is much bigger). The number is nearly the same as it was in 1990. This is on account of the Industrial Policy of 1991 which intended to limit the role of public sector.

Total investment in the public sector units both at the central and state levels is around Rs. 230 thousand crores. About more than 3/4th of this is in central government undertakings. Nearly 69% of this investment is in production of goods, 30% in services and and just 1% in construction. From the investment point of view top three central government undertakings are National Thermal Power Corporation (Rs. 17538 crores), Oil and Natural Gas Commission (Rs. 13496 crores), and Steel Authority of India Limited (Rs. 12876 crores).

The total employment in the public sector in the year 3995 was just less than 2 crores. Out of this nearly 50% is in general services and the remaining in the DCUs and the NDCUs.' Out of the total employment nearly 16% is in transport, storage and communication, nearly 9% in manufacturing, around 7% in financing, 6% in construction and about 5% in electricity, gas and water supply

4.6.3 Private Sector

All production units, both domestic and foreign, owned and managed by private individuals fall in this category, It is difficult to estimate the number of units in the private sector due to the non-availability of data. Only data about the corporate sector is available with some accuracy. Roughly, the whole of primary sector comprising of agriculture, forestry, etc. is in the private sector. Remember that nearly two thirds of India's population is engaged in these occupations.

Private sector is prominent in manufacturing, construction, trade, hotels, restaurants, real estate. etc, It also plays a major role in transport other than railways. It has a very small role to play in the banking and insurance sector. It is virtually non-existent in mining, quarrying, electricity, gas, and water supply. Wherever the private sector plays a smaller or the negligible role it is primarily on account of government laws forbidding their entry into these areas. The Industrial Policy of 1991 has brought hope of the entry of the private sector in these areas.

Data show that there are about more than four lakh companies in the private corporate sector involving more than Rs. 75000 crores of paid up capital. Private sector accounts for nearly 80 per cent of the national income. Public sector contributes the remaining 20 per cent.

With policy of liberalisation since 1991 all barriers in the form of conlrol in the way of private sector are being relaxed gradually. Industrial licensing has been abolished in case of many industries. Direct foreign investment has been made easy. The shares of the public enterprises are now sold to the public. Brakes are being applied to the growth of the public sector. With these developments and with prospects of more economic reforms the future of private sector in India, seems to be bright.

4.6.4 Joint Sector

Joint sector is a partnership between government and private sector, There are differences of opinion when it comes to determining a criterion about minimum partnership in a unit to call it a joint sector unit. We will not go into these different opinions and accept the government position in this regard.

The term 'joint sector' was first used by the Industrial Policy Inquiry Committee (1969) also known as Dutt Committee. The government accepted the term in 1970 through its Industrial Licensing Policy, The four parties that may be involved in a joint sector enterprise are government, private Indian entrepreneur, foreign entrepreneur, and the Indian public. Normally, no single party other than the Indian public is allowed to hold more than 25% of paid up capital without the prior permission of the central government. The limit does not apply to the investing Indian public.

Exact data are not available about the joint sector enterprises in the corporate sector. But according to an estimate about Rs. 11 thousand crores is invested in this sector. This was, in the year 1989-90 and comes to nearly 8% of total investment in the corporate sector.

4.6.5 Cooperative Sector

The cooperative sector is nearly 100 years old in India. But no significant development took place in this sector till 1954. In 1954 the Reserve Bank of India and the Central Government took active interest in the cooperative movement. It has made significant advances in the last 40 years or so.

Initially, cooperative societies were started in India with the purpose of providing cheaper credit to the rural people and save them from the clutches of the professional money lenders. But these societies could not make significant contribution till 1954. In 1954 they were meeting only **3%** of the total credit requirements of the rural people.

In the beginning cooperative societies were confined to the rural areas that too only in the field of credit. Gradually, the movement extended to the marketing and the processing activities. Now it has crossed the rural barrier and reached the urban areas particularly in the field of housing and retail selling. There are housing coopmatives and consumer cooperatives in most big cities, Super Bazar is one example of consumer cooperative. Credit and marketing cooperatives are also found in cities but not that prominent as in rural areas.

According to an estimate there are nearly 3.5 lakhs cooperative societies in India with a total membership of 1750 lakhs and a working capital of Rs. 76 thousand crores. Nearly half of these are the agricultural credit societies. In 1981, these credit societies were meeting nearly 30% of credit requirements of agriculture. Thirty years back in the year 1954 this share was only **3%.** Total credit provided by these societies in a year is about Rs. 10 thousand crores.

Check Your Progress D

1. What is joint sector? Name the possible parties involved in this sector.

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2. Why is mixed economy usually called a mixed capitalist economy?

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4.7 LET US SUM UP,

In this unit we tried to describe the structure of Indian economy with reference to trends in national income, economic growth, economic development, and growth of labor force. National income here means real national income or National Income at Constant Prices (NICOP).The rate of economic-growth of a country is measured by the rate of growth of NICOP. During the first three decades beginning 1951-52 the rate was around **3%.** Over the last 15 years (1981-82 to 1995-96) it is around 5 per cent. The rate of growth was above 5 per cent during 6th and 7th plan. During the first four years of the 8th plan (1992-1996) the rate of growth was above 6 per cent. Economic reforms, particularly from 1991 onwards may have contributed to this rise.

Economic development is described as 'growth plus change'. Growth of NICOP is the quantitative aspect while the 'change' is the qualitative aspect of economic development. The primary goal of economic development is increase in per capita real income, The sub goals of economic development are — reducing inequalities, eliminating poverty, ensuring certain minimum level of consumption; reducing unemployment, raising productivity, reducing regional disparities, increasing modern knowledge, removal of undesiriable conditions in social system and many others.

The main trends in per capita real income are : (a) per capita NICOP is lower by about 2 percentage points as compared to total NICOP throughout the period on account of rise in population by about 2 percent every year; (b) wide fluctuations on year to year basis range from +8.3% to - 8.2%; (c) on ten years average basis per capita NICOP rose at the rate of 1 to 2 per cent during the first three decades and over 3 per cent over the last 15 years (1981-82 to 1995-96). This presents a somewhat promising picture of business environment.

As far as trend in elimination of poverty is concerned although the percentage of people below the poverty line declined from 55% in 1973-74 to 36% in 1993-94 the number in absolute terms remains constant at 32 crores. Other indicators of development present positive evidence about economic development in India.

Labor force of a country depends on age and sex composition, willingness to work and availability of work. It is experienced that alongwith economic development two things happen. First, women's participation in work force increases. Second, percentage of work force in non-agricultural occupations increases. In India the work participation rate of female has increased from 14.2% in 1071 to 22.7% in 1991. It is a sign of qualitative economic development. The percentage of workers in lion-agricultural occupations has remained nearly constant over the last 45 years and has improved marginally between 1981 and 1991. Low productivity in agriculture and slow pace of expansion of employment opportunities in non-agricultural occupations is responsible for the same.

India is a mixed economy where both private and public sectors participate actively in the production process. There are four types of ownership patterns:(1) Private sector, 2) Public sector, 3) Joint sector and 4) Cooperative sector. There has been great expansion of public sector between 1951 and 1991. With the Industrial Policy of 1991 the expansion now has slowed down. This sector has a total investment of about Rs. 230 thousand cores and gives employment to about two crore people.

Private sector is prominent in manufacturing, construction, trade, hotels, restaurants, real estate, ctc. It is virtually lion-existent in mining, quarrying, electricity, gas and water supply. There are about four lakh companies in the private sector involving more than 75 thousand crorcs of paid up capital.

Joint sector is a partnership between Government and private sector. It was introduced for the first time through the Industrial Licensing Policy of 1970. In 1989-90, the total investment in this sector was about Rs. 11 thousand crorcs.

Cooperative sector in India is nearly 100 years old. But it started expanding only after 1954 when the RBI and the Government of India took active interest in it. There are cooperative societies in the field of rural credit, marketing, processing, housing, retail selling. There are about 3.5 lakh cooperative societies in India with a total membership of 1750 lakhs and working capital of Rs. 76 thousand crorcs. Nearly half of these are credit socielies'.

4.8 KEY WORDS

National income : Sum total of factor Incomes accruing to the residents of a country.

Real national income : National income corrected for price change is known as national income at constant prices.

Rate of growth : Rate of increase in red national income.

Per capita real national income : Total real national income divided by total population.

Poverty Hne : Those persons who are below the recommended minimum nutritional requirement level or minimum per capita monthly expenditure limit are said be below the poverty line,

4.9 ANSWERS TO CHECK YOUR PROGRESS

A. 1) a) ii, b) i, c) ii

B. I) a) iii, b) iv, c) iv, d) iii

4.10 TERMINAL QUESTIONS

1. What is the difference between 'money national income' and 'real national income'? Which of the two is an indicator of economic growth and why?
2. What is economic growth? Explain the trends in the rate of economic growth of Indian economy since 1951.
3. Define economic development. In what respect it is different from economic growth? Point out the primary goal and sub goals of economic development.
4. Explain the trends in per capita real income and poverty 'in India since 1951
5. What possible conclusions can you draw on the basis of trends in inequalities of incomes and other indicators about economic development in India'?
6. Explain the aspects of labor force on the basis of which you can draw conculsions about economic development of India.
7. Explain the economic system of India with respect lo the pattern of ownership and organisation.
8. Explain the structure of public sector production units in India.

Note: These questions will help you to understand the Unit better. Try to wrile answers for them, but do not send your answers to the University. These are for your practice only.

UNIT 5 ROLE OF GOVERNMENT IN BUSINESS

Structure

5.0 OBJECTIVES

After studying this unit, you should be able to:

- describe the fourfold roie of the government in the realm of business
- visualise the nature and implications of regulatory role of the government
- spell out the dinlensions of the promotional role to be played by the government
- explain the entrepreneurial character of government's role in the business world
- state the regulatory framework to be structured and the problems faced in providing the regulatory framework
- have an idea about the new role of the government in terms of the new economic policy having privatisation, liberalisation and globalisation as its central theme.

5.1 INTRODUCTION

During seventeenth and eighteenth centuries and even during the early nineteenth century the doctrine of *laissez-faire* prevailed where the role of the government in the sphere of business was virtually zero. The goveniment was supposed to take care of law and order only. But gradually this doctrine started loosing influence and the principal state capitalism was born. Under state capitalism, business remains in the hands of the government and the government was given the responsibility to run, control and regulate the business in the wider interest of the society. But soon it was realised that neither of the two extremes were in the interest of the economic development. As a matter of fact in the world there is no country which can claim to be totally capitalist or totally socialist, The modern so-called capitalist economies are in fact 'mixed economies' with one-third or one-fourth occurring with the government. Similarly so called socialist countries have one-fourlh or one-fifth in the hands of the private sector. The fact is that the extent as well as the type of government's control and participation differs. The mixed economy of India is characterised by the co-existence of public, private, joint and cooperative sectors. The proportion of the mixture is dynamic and is dependent upon various factors. In this unit we throw light on the nature and dimensions of the State participation and intervention in business so that the growth and development of the economy both at the micro and macro levels is not hampered and continues in the positive direction,

5.2 FOURFOLD ROLE OF GOVERNMENT

- The role of the government in the overall economy and business scenario has been changing very fast. In **traditional sense,** the role of any government has been to maintain law and order, to protect the country from external attack, to provide social security, to promote defence production and to exercise control over public utilities. These roles were in the context of providing basic infrastructure to business so that internal environment remains conducive for the business.

But in due course of time certain events took place which brought about significant change in this traditional role. The Russian Revolution of 1917, world depression of 1929, second world war, emphasis of planned economic development have been some of the important factors which gave birth to the idea that business should be socially responsible and for ensuring the discharge of social responsibility by the business the government was entrusted with the obligation of this function. With a view to discharge this function the passive role of the government in the world of business was converted into the active role. The main objective of accelerating and maintaining the pace of economic development with social justice was the foremost consideration. This active role does not imply the state taking over the business in totality.

Since role of the government has shifted from doing the business itself to ensure that the business is run on sound lines the role has assumed four dimensions — **regulatory, promotional, entrepreneurial** and **planning**. The philosophy behind these four roles is founded on the belief that balanced economic development should be planned within the constitutional framework in such a way that public utilities and infrastructural facilities are built up.

Besides these four dimensional roles the state also intervenes in providing direct assistance to business and industries. This assistance is justified because of international competition, financial crisis, and technical complications. Direct assistance can be in the form of providing protection, financial help, technical advice, assistance for research and development, industrial training, and tax incentives. The idea behind these types of direct assistance is to create favourable industrial climate.

Let us discuss the various types of roles played by the government in detail.

5.3 REGULATORY ROLE

The basic objective of regulating business is to (i) prevent the market structure from becoming monopolistic, (ii) developing the small and new entrepreneurs, and (iii) promoting welfare of weaker sections of the society.

Regulatory role involves regulating the business and economic activities of the country by the government. Regulation means directing with the objectives of assisting the conduct of business. It includes controls through which general norms and standards are laid down by the government. This could be done by putting limitations on public utility profits, ceiling on dividends and imposition of excess profit tax. Through regulation undue concentration of economic power in fewer hands and concentration of business in fewer regions is also controlled. It also aims at settling the conflicts between management and the labour.

On the whole regulation attempts to put the business on the right track so that the progress is in conformity with social justice. While regulating business two precautions are necessary. **First,** the legal regulation should not be excessive and **second,** the regulation should be done with efficiency. If these two precautions are not kept in mind regulation may fail to achieve its objective of accelerating the economic development and growth.

The government regulation over business can be **direct** and **indirect**. **Direct controls** are drastic in nature and discretionary in contents. The government at its discretion directly controls business at the micro level from firm to firm or from industry to industry. The main justification of **direct controls** is that since private enterprise has certain imperfections in terms of social justice their activities need regulation so as to justify

economic, political and historical philosophy. For example, industrial licensing system is based on the justification that since the market mechanism fails to allocate the scarce resources for the social optimisation it should be duly regulated.

Indirect controls are indirect in nature and are exercised at macro level through fiscal and monetary incentives, disincentives, penalties and rewards. With a view to develop export oriented industries various types of fiscal and monetary incentives may be given. Similarly high import duty may be imposed with a view to bring down the level of imports.

Regulatory control may achieve its objective only if such control is not excessive and at the same time it is done effectively. To illustrate, in India regulatory control is exercised in the following ways:

i) **Industries (Development and Regulation) Act, 1951:** Its main objective is to promote development and regulate industries. Through this Act

   a) available resources are properly utilised;

   b) concentration of economic power is controlled;

   c) resources are properly allocated; and

   d) new industries are given incentives.

   Under this Act various provisions can be grouped into three broad categories:

   A) Prohibitive provisions providing licensing and registration and controlling scheduled industries;

   B) Curative provisions providing for direct management and control by the government and controlling supply and distribution system and also the prices;

   C) Constructive provisions in the form of setting central advisory boards, review sub committees, permanent committees, development boards and industrial advisory group.

ii) **Industrial Licensing System:** This system aims at controlling the setting up of new industries and increasing the capacity of existing industries. After 1980 various efforts have been made to simplify and liberalise the provisions of this system.

iii) **Control over Capital Issue:** Capital Issue (Control) Act of 1947 provided for the approval of the controller of Capital Issues. This was provided with a view to channellise the capital in the right direction. But during 1991-92 this control has been considerably loosened. Now capital control provisions are within the purview of Indian Securities and Investment Board.

iv) **Price Control:** The central government and various state governments regulate the prices with a view to protect the interest of the consumers.

v) **Distribution Mechanism:** Distribution of items of daily necessities are controlled and regulated through Essential Commodities Act and Public Distribution System (PDS).

vi) **Securities Contract (Regulation) Act:** This is in operation since 1956 and aims at regulating the shares and debentures of companies. This also controls the activities of various stock exchanges. Besides 25 stock exchanges upto 1995 the government has established Over The Counter Exchange of India (OTCEI) and National Stock Exchange (NSE).

vii) **Monopolies and Restrictive Trade Practices Act, 1969:** Its principal objectives were (a) Prevention of concentration of economic power to the common detriment, and (b) control of monopolistic, restrictive and unfair trade practices which are prejudicial to public interest. This Act was significantly amended in 1982, 1984, 1985 and 1991.

viii) **Foreign Exchange Regulation Act (FERA), 1973:** The main objective of this Act has been to regulate the foreign exchange.

ix) **Regulation and Promotion of Foreign Trade:** The Export and Import Policy (EXIM Policy) reflects the foreign trade policy of India. The policy is implemented mostly by means of the regulatory framework provided by the Foreign Trade (Development and Regulation) Act,1992.

x) **Industrial Policy:** In India, Industrial Policies have been announced in 1948. 1956, 1973, 1977. 1980, 1990, and 1991. Through these policies various announcements are made regarding the development of industries falling in private sector, public sector, joint sector, cooperative sector, and small scale sector.

xi) **Regulation of Companies:** Under Companies Act, 1956 the management of capital issue, dividend distribution, loans and advances, share capital and other affairs are controlled and regulated to safeguard the interests of share-holders and creditors.

xii) **Labour Affairs:** Various statutory measures have also been taken by the Government to safeguard and prevent the exploitation of labour. Some of the important laws are: Factories Act, 1948, Workmens' Compensation Act, 1923, Employees' Provident Fund Act, 1952. Payment of Minimum Wages Act, 1948, Maternity Benefit Act, 1961, Payment of Bonus Act, 1975, and Industrial Disputes Act. 1947.

xiii) **Commercial Act:** With a view to regulate operational aspects of trade and business several legislative enactments like. Indian Contract Act, Sales of Goods Act, Negoliable Instruments Act, Arbitration Act, etc. have been passed hy the Government.

xiv) **Miscellaneous Regulatory Enactments:** In addition, various enactments touching different aspects of business like, Trade and Commercial Commodities Marketing Act, 1959, Agricultural Products (Grading and Marking) Act, 1959, Standardised Weights and Measures Act, 1956, Banking Act, and Essential Commodities Act, elc. have also been passed.

Check Your Progress A

i) What was the main reason for government's active role in business?

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ii) Mention the four dimensions that the role of Government assumes.

a) ....

b) ....

c) ....

d) ....

iii) What arc the basic objectives of regulating business?

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iv) State the necessary precautions to be kept in 'mind while regulating business?

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5.4 ENTREPRENEURIAL ROLE

Entrepreneurial role means that the government itself becomes entrepreneur. It means that the ownership comes in the hands of the government. This is called the emergence of puhlic sector. Heavy and basic industries involve high risk and since they do not yield attractive return, they are ignored by the private enterprises. Then there are certain industries where considerable time duration is involved between their establishment and start of production and sales. Therefore in the beginning there might be chances of even earning losses. Rut from the national point of view, at the macro level, they are of vital importance. The government comes forwiud and shows entrepreneurial lead in this direction. Steel, minerals, chemical industry, engineering, irrigation, power and heavy electrical plants are the examples. The public sector is therefore, assigned the entrepreneurial role.

The Industrial Policy Resolution of 1948 had very clearly provided that the manufacture of arms and ammunition, the production and control of atomic energy, and the ownership arid management of railway transport would be the exclusive monopoly of the central government. It was also provided that in another six industries i.e. coal, iron and steel, aircraft manufacture, ship huilding, manufacture of telephone, telegraph and wireless apparatus and mineral ore: the new entrepreneurial units would be set up by the State alone.

The Industrial Policy Resolution of 1956 had further enlarged this role of the government. Schedule A of 1956 Resolution contained 17 industries, the future development of which was made the exclusive right of the government. Further, Schedule B of the Resolution contained a list of 12 industries which were to be progressively State-owned and in which the State was supposed to take initiative in establishing new units. Since then the entrepreneurial role of the government went on increasing.

Investment in undertakings hy the central government increased from Rs.29 crores in five units in 1951 to over 1.18 lakhs crores in 237 operating units at the commencement of the eighth plan. Besides there were also 1100 state level public enterprises which have an estimated investment of about Rs. 50,000 crores. The entrepreneurial role cloes not mean only setting up of new enterprises. Nationalisation of certain industries and business institutions like coal, copper, insurance, commercial banks and taking over of a number of sick units also contributed lo the growth of entrepreneurial role of the government.

The entrepreneurial role of the government needs closer scrutiny. In India a large number of puhlic sector entrepreneurial units have been making huge losses. Most of the loss making units are either in the non-priority sectors or the sectors where the private enterprises have proved to he more efficient. **A** number of these loss making units are also sick. Various reasons are given for this sad state of affairs. Allocation of resources, delays in filling up the top-level posts, tight regulations and procedures for investment and restrictions on functional and operational autonomy of the enterprises are some of the reasons which are acting as constraints on the operational efficiency of state entrepreneurial venture. These units have to be run like business units and not as government units. The bureaucratic attitude has to be converted into practical business theme.

Since such enterprises have been victims of poor project management, over manning, lack of technical upgradation and inadequate attention towards research and development the growth of these enterprises became a burden on the government and serious thinking was done to arrive at some practical way. The New Industrial Policy which was announced in July 1993 redefined the entrepreneurial role of the government. As per this new policy, the priority areas for the public sector were (a) essential infrastructure goods and services, (b) exploration and exploitation of oil and mineral resources, (c) technological development and building of manufacturing capabilities in those areas which are crucial in the long term development of the economy and where the private sector investment is not adequate, and (d) manufacture of products in areas where strategic considerations are of paramount importance. The number of industries reserved for government has been reduced to only eight. As a step towards privatisation it also abolished public sector monopoly in several industries like, iron and steel, power, ship building, telephone, aircraft, heavy plant and machinery.

Further existing portfolio of public investment is being reviewed with a view to off load public investment in areas where certain conditions prevail. These conditions are : (a) industries based on low technology, (b) inefficient and unproductive areas, areas with low or zero social responsibility, (c) areas where private sector has developed sufficient entrepreneurial skills and (d) small and non-strategic areas.

Thus under the New Economic Policy the scope of entrepreneurial role of the government has been substantially modified. The emphasis has been shifted towards performance improvement and it is clear that the government has to ensure that public enterprises are made to run on business lines. Reorientation of approach on the part of the government corresponding to liberlisation and dismantling of regulations to develop the institutional ability and evolution of consensus and partnership among stackholders are the new dimensions of the entrepreneurial role of the government in India.

5.5 PROMOTIONAL ROLE

The promotional role played by the government is indirect. Here the government neither interferes in the functioning of the business nor makes any attempt to regulate. But instead of playing as a member of the team it aims at promoting the business by providing adequate infrastructure, providing suitable environment and by offering various incentives so as to boost the morale and operational activities of business. All types of economic systems whether developed or developing look for the promotional efforts of the government. Under this role the government builds up development oriented basic structure which includes construction of roads, bridges, supply of water and power, efficient transport facilities, building industrial regions and estates, existence of district industrial centers, counselling centers, development centers, communication system, provision of industrial training and financial banking and marketing network. The government plays the role of coordinating various sectors of the economy — public, private, joint and cooperative — and in doing so it takes various motivational measures.

There are various functions of the government in promoting the business operations. These are:

i) To maintain public utilities

ii) To encourage the developmental attitude among various sectors

iii) To make economic resources productive and progressive

iv) To affect the effective utilisation of various resources

v) To ensure equitable distribution of wealth and income

vi) To bring about equitable balance between various regions

vii) To control the quantity of money available in terms of developmental needs

viii) To promote investment climate in the country

ix) To provide incentives for the promotion of foreign trade

The promotional role of the government thus encompasses fiscal, monetary and budgetary incentives for the fast expansion and development of priority sectors of the economy, In Unit 6 you will study these policies in detail.

5.6 PLANNING ROLE

In a developing country like India the role of government as a planner is very important. This is so because in modern times government is supposed to be the custodian of the welfare of the society. For the welfare of all, balanced prosperity has to be achieved. Since the objectives as well as means to achieve the objectives are different it becomes necessary that objectives are clearly defined. Since resources are always limited they have to be allocated in such a way that optimum utilisation brings optimum returns. This calls for laying down the priorities, All this is done by planning. In other words planning role implies that the government has to plan so that limited resources are directed to right objects with a view to achieve the defined objectives in the interest of all concerned.

Planning is universal. Every economic unit at the micro level has to plan its activities. Similarly at the macro level planning has to be done collectively for the country and within the limits set by the government micro level planning is done. Thus the planning role of the government means setting by the government the outer Limits or the broader limits within which micro level operations will be planned and executed.

In the context of planning role there can be comprehensive or piecemeal planning. Comprehensive planning involves a series of activities over a given period for the economy as a whole. Our five year plans are the examples of such planning. Piecemeal planning on the other hand is temporary or ad-hoc having the objective of meeting some contingent or temporary situation. For instance, planning a reconstruction after war or social security plan or even 20 point Economic Programme.

Similarly from the point of time horizon we can have long term plans or short term plans. Within the long term horizon we hear of short term programmes. Then planning role can also he classified in terms of organisational dimension. 'There can be centralised or decentralised planning. Centralised planning comes from the top which is passed on to the state level and then downward. Decentralised planning starts from the bottom i.e. from individual unit say panchayat level, sectoral level, regional level and then national level. Whatever the type of planning the role has to be exercised with caution.

There are certain distinct steps since planning involves some kind of intervention with the free market operation of the economy. The goal has to be set in terins of socio-economic objectives. These objectives represent the political ideology and also suggest a broad framework within which priorities are set. These objectives could be in terms of economic growth, social justice, full employment, stability and ecological balance. Once the socio-economic objectives are identified physical targets are set for various sectors. Having laid down the targets instruments are specified to attain the targets. Instruments means a detailed outline of policy-mix. The policy mix consists of monetary, physical and fiscal policies. These instruments thus provide operational meaning to the objectives and targets. Implementation has also to he planned in terms of methods of execution. A plan very often fails because of faulty implementation. Lastly, performance of the process of planning has to be appraised periodically **with** a view lo get a feedback over the performancc. Through appraisal flexihility is ensured and changes are made for future effecliveness.

The planning role of the government has to he balanced and optimal. Optimal and balance have to he in terms of economic viability 'and social desirability.

Check Your Progress B

i) Mention the priority areas for the public sector according to the New Induslrial Policy, 1991.

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ii) State various functions of the government in promoting the business operations.

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iii) Mention about the new dimensions of the entrepreneurial role of the Government.

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iv) List any five functions of Government in promoting business operations.

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5.7 REGULATORY FRAMEWORK

Formulation and implementation are the two aspects of development. Regulatory framework provides the hridge. In other words the effectiveness of plans depends not only on the way in which it is formulated, but more on the manner in which it is implemented. For implementation it requires legislative support. This legislative support enables interaction between the economic and politico-legal environment. Under section 5.3 various regulatory measures have been discussed. Given below is a list of various basic legislations which have been enacted by government to make the role of government more productive and meaningful.

1. **Monopolies and Restrictive Trade Practices Act, 1969:** This Act has three objectives : (i) to control and regulate the concentration of economic power in a few hands of business and industry, (ii) to control monopolies and monopolistic trade practices, (iii) to prohibit restrictive trade practices unless one can be justified in the public interest.

2. **Companies Act, 1956:** Based on the recommendations of the Bhabha Committee the Companies Act has five objectives: (i) to maintain minimum standard of business integrity and conduct in promotion and management of companies, (ii) fair and full disclosure of all reasonable information relating to the affairs of the company, (iii) to ensure effective participation and control hy shareholders and the prolection of their interest, (iv) to enforce proper performance of duties by the company management, (v) to intervene and investigate into the affairs of companies which are managed against the interests of the shareholders and the public.

3. **Foreign Exchange Regulation Act, 1947:** This Act was amended in 1957, 1965 and 1973 and as per latest amendments it aims at exercising control over (i) the activities of the multinational business, (ii) the flow of foreign capital, technology **and** managerial enterprises, and (iii) foreign collaboration and joint ventures.

4. **Capital Issues Control Act, 1956 and Securities Contracts Regulation Act:** These two Acts recognize the twin roles of the government as promoter and protector of the capital market and shareholders respectively. They aim at ensuring an efficient allocation of scarce capital resources in productive investment ventures.

5. **Essential Commodities Act, 1974:** It aims at ensuring proper supply and distribution of essential commodities and is directed against the anti-social elements Iikc hoarders, profiteers and blackmarketeers in foodgrains.

6. **The Banking Service Commission Act, 1975:** It provides for the establishment of a commission for the selection of personnel of nationalised banks:

7. **The Industrial Relations Act 1978:** It aims at improving industrial relations in the country.

8. **The Sick Textile. Undertakings (Nationalisation) Act, 1974:** It provided for the nationalisation of 103 sick textile mills with the objective of augmenting the production and distribution of different varieties of cloth at fair prices.

9. **The Urban Land (Ceiling and Regulation) Act, 1976:** The main purpose of this Act is to curb growing inequalities in the distribution of unearned income and wealth. It specifies a ceiling on the plinth area of the future houses and imposes governmental control on the sale and transfer of any urban property.

10. **The Companies (Temporary Restrictions on Dividends) Act,1974:** The Act aims **at** curbing consumer spending and promoting savings in the economy. With this end in

view it provides that dividends declared by certain companies should not exceed one-third of the net profits after tax or an amount equal lo 12 percent on the face value of equity shares of the company.

11. **Workers' Participation in Management Bill, 1990:** Under this an attempt has been made to popularise participative management at various levels through legislative measures.

12. **Sick Industrial Companies Act, 1985:** This Act provided for the setting up of a Board for Industrial and Financial Reconstruction (BIFR). This aims at scrutinizing the management and actual state of affairs of the companies claiming to be sick.

13. **The Consumer Protection Act, 1986:** The primary objective of this Act is to protect the interest of the consumers by establishing consumer councils and other related authorities for the settlement of consumer's disputes.

14. **Industries (Development and Regulation)Act, 1951:** This Act provides regulatory framework for the development, regulation of industries with a view to bring it in tune with country's economic, social and political yhilosophy.

    Under this Act the government has the authority to effectively use the available resources of the country, develop small and cottage industries, and take measures to bring about regional development of the country in a balanced manner.

Regulatory provisions have **three** parts –

i) administrative, ii) controlling, and iii) counselling.

i) **Administrative provisions** are some times referred to as restrictive in nature and their observance is compulsory for the industries. In case of default penal action can be initiated.

ii) **Controlling provisions** are curative in nature and provides for controlling their operations. The government exercised control over supply, distribution, prices and also management.

iii) **Counselling provisions** provide for the setting up of various advisory bodies having representatives of various parties to analyse specific problems and offer possible solutions. Some such advisory bodies arc: Central Advisory Council, Standing Committee of the Central Advisory Council, Review Sub-committee, Development Councils. Provision has also been made for the setting up of Industrial Panels to bc set up in cases where setting up of Development Councils is not possible.

A review of some of the most important legislative measures makes it clear that we have provided a very sound, comprehensive and exhaustive regulatory frame work for the regulation of business in India. But the main problem lies in the direction of their effective implementation. We have too many laws hut their observance is doubtful. Inspite of host of legislative enactments we have not been able to achieve the objectives. Thus there is the need to evolve some machinery which could ensure their observance.

5.8 REDEFINED ROLE OF GOVERNMENT

The Directive principles of state Policy as maintained in the Indian Constitution provide for the requirement to shoulder heavy responsibility to attain the economic goals. Any responsibility cannot be discharged unless commensurate authority is bestowed. Thus the government has assumed wide powers of controlling the economy. Accordingly the government has been very active in discharging its fourfold role i.e. regulatory, promotional, entrepreneurial and planning. But recenlly the question has come as to what extent these four roles played hy the government have brought about desired economic growth quantitatively as well as qualitatively ? Various revolutionary changes taking place in the communist countries have revealed the miserable failure of the State regime to put an end to the economic misery. The experiences of various countries revealed four significant facts: i) the command economy has failed to make the business work efficiently, ii) the market economy has been found to be a better instrument for producing products

needed by the people and for distributing them equitably than the centrally planned system. iii) foreign technology and investment are considered very important for reconstructing and developing the econonly of developing countries, and iv) the transition to a market-driven system is considered compatible with the positive social aspects of the old system.

In India since the very beginning the role of the government has been in chaotic stage. No doubt considerable economic progress has been made. But these changes have been only in quantitative terms. In quantitative terms also the rate of growth has been highly unsatisfactory when compared with the development taking place in south eastern countries, say, Korea, Malaysia, Japan and Singapore.

Thus with the growing realisation towards the inadequacy and ineffective results of the State's role it was considered necessary to redefine the role of the government and in doing so liberalisation measures were introduced around the beginning of the 1980s. This trend reached a stage in 1991 when New Industrial Policy announced major changes in terms of privatisation, liberalisation and globalisation. The objectives of these revolutionary changes were : i) to accelerate economic development; ii) to have better capital utilisation; iii) to achieve economies of scale; iv) to develop backward areas and to remove regional disparities in terms of development; v) to promote export and import substitution; vi) to increase competitiveness in terms of quality and effectiveness hy cost reduction, waste elimination and increase in efficiency; and vii) to achieve respectable place in the global business.

The new policy acknowledges that with the growth and complexity of industrial structure and environment, the interference of government through various legislalive measures needs to he considerably lowered and cut down. The features of the New Industrial Policy of 1991 are:

i) Delicencing

ii) Scrapping MRTP regulations concerning concentration of economic power

iii) Liberlisation of foreign investment and technological participation.

iv) Redefining the role of public sector.

The new policy envisages selective privatisation of enterprises. It has also been decided to close down unviable public enterprises and to bring lhe viable sick units of the public sector under the Board for Industrial and Financial Reconstruction (BIFR). The policy is to abolish the monopoly of any seclor private or puhlic in the field of manufacture, except on strategic or military consideration and open all the manufacturing activities to competition. It also proposes privatisation hy selling shares to mutual funds, workers and public.

The existing portfolio of public investment is also being changed with a view to off load the puhlic investment from areas where certain conditions are found. These conditions are: i) industries based on low technologies, ii) small scale and 11011-strategic areas, iii) inefficient and unproductive areas, iv) areas with low or zero social responsibility or public purpose, and v) areas where private sector has developed sufficient expertise.

The new role of government envisages setting up an environment for privatisation. Turning public sector into joint sector ventures by private participation has also been initiated. The government is now withdrawing from those areas where private enterprises will he more efficient. Thus privatisation in phases has been planued. This new role is likely to reduce the budgetary burden on the public, to make available more resources for developmental activities, to enable the government to concentrate more on the essential government functions and priority areas and to relieve the consumers from the indifferent and arrogant attitude of public sector. Thus in terms of redefined approach it would be appropriate to say that the role of the government will in future be to provide the infrastructure and environment for the healthy growth with justice of the economy of the country. The role envisages that the State should concentrate more on the effective discharge of its essential functions and on dealing with the priority issues than laying its hands on every thing creating an unwidely amount of activities, wasting the scarce resources and putting more burden on the shoulders of the common man. It has to provide motivation through positive measures.

Check Your Progress C

i) State the major objectives of New Industrial Policy of 1991.

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ii) List the main fealures of the ahovc policy.

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5.9 LET US SUM UP

The role of the government in boosting business has been constantly undergoing change. From laissez faire philosophy the government's role started moving towards state dominance and the entire rcsponsihility for the growth and development of business was put on the shoulders of the government. This brought the emergence of totalitarian type of economic system. But very soon it was realised that totalitarian system cannot bring the desired results. Thus the government's role was more precisely defined in terms of regulation, promotion: participation and legislation. But very soon it also became clear that even these areas of interference need some input of liberalisation. Realisation resulted in changing command economy to market economy. Thus based on the experiences of other countries and also our own experience the goal has again been redefined in terms of liberalisation and privatisation. But the emphasis on growth with social justice has gained upper hand.

5.10 KEY WORDS

Business : Any activity carried on with a view to earn profit.

Capitalism : An economic system where means ot' production and distribution are in the hands of private sector.

Cooperative Sector : It involves wider dispersal of ownership of production and active involvement of people in developmental programmes.

Decentralised Planning : Planning where decision making and implementation flows from the bottom.

Entrepreneurship : State in which risk bearing is associated with the business activity.

Fiscal Measures : Measures and activities related to revenue and money.

Import Duty : Tax levied on the goods imported within the country.

Incentives : Encouragement in monetary or non-monetary terms to encourage some activity.

Laissez-faire : The principle of bringing about economic development freely without government control or interferencc,

Licensing System : System in which government's approval is necessary for setting or stating any industry.

Market Mechanism : Interaction between demand, supply and prices and response of decision making units to changes in prices.

Mixed Economy : An economic system where private as well as public sectors co-exist.

Private Sector : Sector in which means of production and distribution are privately owned and controlled.

Public-sector : Sector where means of production and distribution arc owned end controlled by the government.

Public Utilities : Those undertakings which manufacture and distribute items of public services.

Sick Units : Units which arc not working economically in terms of profitability and rate of return on investment.

Socialism : An economic system in which means of production and distribution belong to State and activities are carried on keeping in view the welfare of the society.

5.11 TERMINAL QUESTIONS

1. What do you understand by the promotional rolc of the government'! Discuss.
2. Explain the nature and implications of regulatory rolc of the government.
3. Explain the entrepreneurial character of government's rolc in the business world.
4. What problems come in the way of structuring the regulatory rolc of the government in business? How can they be overcome'!
5. Explain the execution of planning rolc by the government in India's industrial development.

A. Examine the nature and dimensions of the role of the government in the context of business after the announcement of New Industrial policy in 1991.

Note: These questions will help you lo understand the Unit better. Try to write answers for them. but do not send your answers to the University. These are for your practice only.

UNIT 6 MACRO ECONOMIC POLICIES

Structure

6.0 OBJECTIVES

After studying this unit, you should he ahle to:

- explain the meaning of macro economic policy.
- explain the meaning and objectives of fiscal policy.
- slate the instruments of fiscal policy.
- explain the meaning and objectives of monetary policy.
- state the meaning and functions of a Central Bank.
- explain the concept of money supply in India.
- distinguish between quantitative and qualitative instruments of monetary policy.
- explain the role of Reserve Bank of India.

6.1 INTRODUCTION

The term macro in economics means 'relating to a nation'. Macro economic policy thus means a policy about economic aspects of a country. A national level policy is framed by the central government of the country. It is implemented by its various departments or by the specialized institutions created for this purpose.

The central government of a country follows specific policies 'with respect to agriculture, industry, services, employment, money supply, credit, taxes, government expenditure, borrowings, etc. All these are macro economic policies. These policies affect particular economic sectors in some cases and the entire economy cutting across all seclors of the economy in other cases. For example, any economic policy about agriculture is designed to regulate mainly the development of agricultural sector . Take another example say of taxation policy. It may affect all economic sectors of the economy: i.e. the entire economy. Such policy is truly a national level policy. Other examples of national level policies are policies regarding money supply, credit, employment, education, etc.

In this unit you will study two national level policies popularly known as fiscal and monetary policies. The fiscal policy aims at regulating the functioning and development of different sectors of an economy through affecting changes in government expenditure and taxation system. Monetary policy tries to fulfill the same aim through regulating money supply and through this the credit and investment conditions in the economy.

6.2 MEANING OF MACRO ECONOMIC POLICY

A macro economic policy refers to the deliberale measures taken at national level to regulate the functioning, growth and development of the economy and its sectors. The policy is framed by Government and implemented through institutions controlled or sponsored by the Government. Out of the various macro economic policies the two crucial ones are fiscal and monetary policies.

Fiscal policy is the income and expenditure policy of the government. Government needs money to run the country's administration, to provide facilities to the people and the business, to undertake developmental activities and so on. Tax is the main source of income for any government. The type of laxes government imposes has a great bearing on development of the various sectors of the economy, Government uses taxation as a tool for regulating economic activities in the country within the framework of over all policy objectives. Government expenditure is another tool . Government's spending has a bearing on the standard of living of the people, the business environment, the growth of various sectors. etc. The fiscal policy of a counlry finds its expression in government budget.

Monetary policy of a country broadly aims at regulating the money supply in the counlry. Regulation of money supply in the country has its affect on interest structure, credit structure, investment structure, prices, flow of foreign exchange etc. The policy is prepared by the central bank of the counlry and implemented mainly through the commercial banks. Reserve Bank of India is the central bank in India. State Bank of India, Punjab National Bank, Canara Bank, Union Bank of India, UTI Bank, Times Bank, etc. are the examples of commercial banks. In practice nearly all the financial institutions, banking or non - banking are involved in the implementation of the monetary policy, directly or indirectly.

Mosl of the objectives of monetary and fiscal policies are common. The ultimate aim of both policies is economic growth and development of the country. In the following sections we will have a look into the various objectives, instruments and the government agencies responsible for implementation of fiscal and monetary policies in India.

6.3 MEANING OF FISCAL POLICY

The adjective 'fiscal' is derived from the noun "fisc" (from Latin fiscus). Fisc means a stale or state treasury. The word fiscal, therefore, refers to all matters pertaining to state treasury, particularly its source of revenues and its patterns of expenditures. Accordingly fiscal policy deals with government's power to tax and spend for the purpose of achieving certain declared policy objectives which generally relate to prices, output and employment.

There are two fundamental issues of fiscal policy. **First**, should taxes be raised or lowered? **Second**, should government spending be reduced or increased? Lowering taxes and raising government expenditure raises demand and helps in the expansion of economy. Raising taxes and cutting government expenditure reduces demand and has the effect of contracting the economy. The main concern of the fiscal policy thus is the ways in which the government raises and spends money. Government raises money through taxation,

borrowing and printing new money. Each source has its own implication. Government spends money on public works and transfer payments. Public works include roads, parks, bridges, government buildings, water supply, electricity supply, educational institutions etc. Transfer payments are in the form of old age pensions, interest payments, etc.

Fiscal activity can be **discretionary** and **non - discretionary. A discretionary** fiscal· activity means deliberate actions by the government in spending and taxing to influence the nation's output and employment or to correct the situation arising from inflationary or deflationary tendencies in the economy. A **non - discretionary** fiscal activity means changes in government spending and taxes taking place automatically without any explicit decisions by the finance minister. For example, during inflationary situation an already existing progressive income tax policy has the effect of reducing people's power of spending. The distinction between discretionary and non - discretionary fiscal activities can he used to state the meaning of fiscal policy a little more precisely.'

To be more precise, **fiscal policy in the modern sense refers to the deliberate actions by the government in its spending and taxing activities to achieve certain objectives** like that of price stability and raise output and employment to the desired levels. Thus the modern fiscal policy is essentially a discretionary fiscal policy.

6.4 INSTRUMENTS OF FISCAL POLICY IN INDIA

As mentioned above, fiscal policy refers to the delihcrate actions by the government in its spending and taxing activities. Broadly, fiscal policy in the Indian context involves the ways in which the central government raises and spends money. Let us explain these two aspects in detail.

6.4.1 Ways of Raising Money

How the government chooses to raise money? The ways of raising money are technically termed as 'sources of revenue' in public finance. These sources of revenue are one set of instruments of fiscal policy. Basically, a government has three sources of revenue : a) taxation, b) borrowing and c) printing new money. In India there is an additional source in the form of non - tax revenue. Out of these the printing of new money is generally the last resort. In the Indian context there are three ways of raising money (sources of revenue).

1) Tax revenue
2) Non - Lax revenue
3) Capital receipts

Let us briefly describe each source of revenue.

1) **Tax revenue: A** Lax is a compulsory payment to government. Taxes can be levied and classified in many ways. There are three principal types of taxes in any system: taxes on incomes? wealth, and activities of production, consumption etc. Main taxes levied by central government are:

   1. Corporation tax
   2. Income tax
   3. Interest tax
   4. Expenditure tax
   5. Wealth tax
   6. Gift tax
   7. Customs
   8. Union excise duties
   9. Service tax
   10. Other taxes and duties
   11. Taxes on union territories

Out of the ahove the principal taxes in order of importance in the budget of the year 1997-98 are union excise duties (34%), customs (34%), income tax (14%) and corporation tax (14%). These four taxes together constitute nearly the entire gross tax revenue of the central goveriiment. The taxes, other than these four, constitute only about 3% of gross tax revenue. Income tax is the tax on income of the individuals. Corporation tax is also an income tax but on the profits of companies, i.e. before these profits are distributed to the owners of the companies. These two together constitute about 28% of gross Lax revenue.

Income tax is a useful tool of reducing inequalities in the distribution of income, Union excise duties are taxes on manufacturing of goods. Customs are the taxes on imports and exports of goods, in India mainly on imports. More than two third of the total tax revenue comes from union excise duties and customs.

2) **Non - tax revenue:** It comprises of (i) interest on loaiis to slates and union territories (ii) interest payable by government eulerprises (iii) dividends and profits from public sector enterprises (iv) external grants (v) receipts from union territories. Out of the total non-tax revenue over 60% is from interest (i.e. (i) and (ii) (above). Dividends and profits from public sector enterprises constitute nearly 15%.

3) **Capital receipts:** The main items of capital receipts arc loans raised by the government from public which are called market loans: borrowings hy government from Reserve Bank and other parties through sale of treasury hills, loans received from foreign governments and hodies and recovery of loans granted by Central Government to the State and Union territory governments and other parties. Broadly capital receipts constitute fresh loans made and loans recovered. Out of the total borrowings the loans from the RBI constitute 'deficit financing'. The implication of deficit financing is that this directly leads to printing of notes leading to net additions to money supply in the economy. In 1997-98 hudget it is to the tune of Rs. 16,000 crores representing nearly 1/4 of total fiscal deficit. Another source of capital receipts is the resale of the share of puhlic sector undertakings.

The comparative position of the three categories of receipts in 1997-98 budget of the Central Government is summed up in the Table 6.1

Table 6.1 : Receipts of Central Government of India
(Budget Estimates 1997-98)

Source of revenue	Amount (Rs. Crores)	(Percentage of total)
1. **Tax** revenue	**153143**	**56%**
2. Non-tax revenue	39750	15%
3. Capital receipts	79033	29%
Total	271926	100%

Clearly the government is dependent on borrowings (Capital receipts) to the tune of nearly 29%. It means to meet every one rupee of its expenditure government has to borrow 29 paise, This is the real burden for the government in the form of future liability of repayment of loans and interest.

6.4.2 Ways of Spencling Money

This is the second aspect of fiscal policy. The budget of the central government classifies public expenditure into (a) plan expenditure and (b) lion-plan expenditure. Each in turn is sub-divided into (i) revenue and (ii) capital expenditures.

Plan expenditure includes provision of expenditure for various projects, programmes and schemes included in the Central plan for the given year. **Non-plan expenditure** covers all expenditures of government not included in the plan. It includes (a) expenditure obligatory in nature, for example, interest payments, expenditure on defence and internal security, etc; (b) expenditure on maintaining the assets created in the previous plans and (c) expenditure on continuing services and activities at levels already reached in a plan period. Thus as more plans are completed the non-plan expenditure increases.

Revenue expenditure is the expenditure which does not result in creation of assets. It is for the normal running of government departments and various services, interest charges on

debt incurred by government, subsidies, grants to state governments and other parties. **Capital expenditure** consists of expenditure on acquisition of assets like land, buildings, machinery, equipment, shares, etc.

The relative position of plan and non - plan expenditure in 1997-98 Budget estimates of the central government is given in Table 6.2

Table 6.2 : Expenditure of the Central Government (Budget Estimates 1997-98)

Types of **expenditure**	**Amount** (Rs. Crores)	**Percentage** of total expenditure
1. Non - Plan Expenditure		
a. Revenue Expenditure	145854	63%
b Capital Expenditure	23470	10%
Total (a + b)	169324	73%
2. Plan Expenditure		
c. Revenue Expenditure	37554	16%
d. Capital Expenditure	25298	11%
Total (c + d)	62,852	27%
3. Total Expenditure		
(Plan + Non Plan)	232176	100%

Plan expenditure is 27% of total budget expenditure. Nearly 314 of total expenditure is non - plan. This is because we have completed eight five year plans which means a total of 46 years of planning period and as more plans are completed, non - plan expenditure increases,

Capital expenditure is nearly 1/5 of total expenditure. Remaining 415th is routine revenue expenditure. A good part-of expenditure is on transfer payments like pensions, interest payments, subsidies etc. It will help in creation of income and employment if spent on goods and services by the recipients, 111 any case transfer payments is a very useful instrument of redistributing income in favour of the poor sections of the society. Capital expenditure, on the other hand. stimulates capital for nation, provides socially useful goods such as parks, roads, schools, hospitals etc, and provides jobs. It is a very good instrument of enhancing capital base of h e nation, creating infrastructure facilities, and stimulating income earning capacity of the society.

Check Your Progress A

1. What is a macro economic policy?

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2. Name the three ways of raising money by the Government of India.

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6.5 BUDGETARY FRAMEWORK IN INDIA

6.5.1 Summary Format of Budget

A summary format of the budget estimates of the Central Government of India for the

year 1997-98 is given below (Table 6.3). This format aims at highlighting deficit position during the year. There are many concepts of deficit e.g. revenue, budgetary, fiscal and primary deficit. Of these fiscal deficit is considered a comprehensive measure of deficit as compared to other. Let us explain the meaning of each type of deficit.

Table 6.3 : **Budget Estimates of Government of India for the year 1997-98**

		Amount in (Rs. Crores)
1.	**Revenue Receipts**	153143
2.	Tax Revenue (Net to Centre)	113394
3.	Non-Tax Revenue	39749
4.	**Capital Receipts**	79033
5.	Recoveries of Loans	8779
6.	Other Receipts	4800
7.	Borrowings and other liabilities (including 91-clays Treasury Bills)	65454
8.	**Total Receipts** (1+ 4)	**232176**
9.	**Non-Plan Expenditure**	**169234**
10.	On Revenue Account Of which	145854
11.	Interest Payments	68000
12.	On Capital Account	23470
13.	**Plan Expenditure**	**62852**
14.	On Revenue Account	37554
15.	On Capital Account	25298
16.	**Total Expenditure (9+** 13)	**232176**
17.	Revenue Expenditure (10+14)	183408
18.	Capital Expcnditum (12 + 15)	48768
19.	**Revenue Deficit** (1 - 17)	**30266**
20.	**Budgetary Deficit** (8-16)	#
21.	**Fiscal Deficit** (1 + 5 + 6)- 16	**65454**
22.	**Monetised Fiscal Deficit $**	16000
23.	**Primary Deficit** (21 - **11)** 153143	-2546

\# With the discontinuance of the ad-hoc Tresury bills and tap 91 days Treasury bills the concept of conventional budget deficit loses its relevance.

$ Expected level of RBI support to Central Government borrowing.

Source : Budget At A Glance : 1997-98, Ministry of Finance, Government of India.

6.5.2 Measures of Deficit

A deficit is said to occur when budget expenditure exceeds budget receipts. There are various concepts of deficits depending upon the type of expenditures and receipts taken into consideration. In the central government's budget of India three types of deficits are recorded. These are revenue deficit, gross fiscal deficit and gross primary deficit.

1. Revenue Deficit : Revenue deficit equals the excess of revenue expenditure (both plan and non-plan) and revenue (both tax and non-tax) receipts. This deficit represents only part of the hudget. Revenue receipts are the receipts of routine nature and do not lead to any addition to the liabilities of the government. Revenue expenditure, is the expenditure of routine nature not involving creation of any assets. **As** such the revenue deficit indicates the extent to which the current receipts are insufficient to meet the current expenditure.

2. Budgetary Deficit : Budgetary deficit equals the excess of total expenditure over total receipts. This includes both revenue and capital items. In the 1997-98 budget onwards total expenditure and total receipts are necessarily equal and for all practical purposes the concept of budget deficit becomes irrelevant.

3. Gross Fiscal Deficit : It equals excess of total expenditure over total receipts excluding horrowings and other liahilities. In the 1997-98 hudget it equals borrowings and other liabilities (including 91 days treasury bills). It is a measure of total borrowing requirements of the central government. During 1997-98 it was Rs. 64454 crores.

Fiscal deficil is the most relevant of all the measures of deficit. It is a measure of real volume of problem of financing expenditure. It also indicates increase in liabilities during the year and increase in liabilities during coining years on account of interest payments.

4. Primary Deficit : Primary deficit equals gross fiscal deficit less gross interest payments. Gross fiscal deficit equals borrowings and other liabilities. So primary deficit equals borrowing less interest payments. This is a measure of horrowing requirements other than to meet the interest obligations. Interest payments are the result of past liahilities. Primary deficit is a measure of liabilities arising a fresh on account of' current expenditures.

6.5.3 Sources of Financing Gross Fiscal Deficit

From 1997-98 budget estimates gross fiscal deficit (GFD) for all practical purposes equals 'borrowing and other liabilities'. GFD is most relevant concept of deficit indicating the volume of problem of financing deficit before the central government. The main sources of borrowing, arranged in order of importance are :

1) **Other (i.e. other than market loan) long term and medium term borrowings:** The loans comprise conversion of treasury bills.
2) **Small savings, PPF and other deposit schemes for retiring government employees:** This includes deposit mobilization through post office saving schemes, public provident fund, and the schemes for retired government employees.
3) **Special deposit schemes:** This is in the form of investments by non - government provident funds, super annuation and gratuity funds of Life Insurance Corporation, Employee's State Insurance Corporation, etc.
4) **Market loans** : These loans ire raised by selling government securities.
5) **Short term borrowings** : These are in the form of 364 days treasury bills offered to the financial institutions and other parties.
6) **State provident funds** : This source includes provident funds of government employees.
7) **Gold bonds** : These bonds mobilize idle gold resources of ordinary citizens to supplement the official reserves.
8) **External assistance** : This constitutes borrowings from foreign countries.

The relative importance of the above sources is given in Table 6.4.

Table 6.4 : Sources of financing fiscal deficit - Budget estimates 1997-98

Sources of financing	Amount (Rs. Crores)	Percentage of total
1. Other short-term, medium term and long term borrowings	29750	45.5
2. Small Savings, PPF and other deposit schemes for retired government employees	14,000	21.4
3. Special deposit schemes	10,006	15.3
4. Market borrowings	4,070	6.2
5. State provident funds	2,550	3.9
6. External assistance	2,435	3.7
7. Other receipts	2,643	4.0
Total	65,454	100.0

Of the above source 1-5 and 7 are internal borrowings and 6 is external borrowings. So more than 96% of financing is from within the country and about 4% from foreign countries. Total accumulation of public debt and other liabilities of the central government since 1950-51 is shown in Table 6.5.

Table 6.5 : Accumulated public debt and other liabilities of Government of India

Source	1950-51		1997-98	
	Amount (Rs. crores)	Percentage	Amount (Rs. crores)	Percentage
Internal	2830	99	677290	92
External	30	1	56000	8
Total	2860	100	733920	100

The main short term implication of the above debt is the payment of huge sum of money as interest every year. In the 1997-98 budget estimates the interest payments amounted to Rs. 68,000 crores. This amounts to nearly 30% of total expenditure during the year.

6.6 OBJECTIVES OF FISCAL POLICY

Fiscal policy deals with government's power to tax and spend for the purpose of achieving certain declared policy objectives. It refers to deliberate actions by the government in its spending and taxing activities to achieve certain objectives. The three basic **objectives** of fiscal policy are promoting economic growth, employment and price stability. There are other objectives also. Let us have a. look at these objectives.

(1) Promoting economic growth

Economic growth means raising the level of real output. Government promotes economic growth in many ways. It creates conditions suitable for raising productions. For this purpose the government follows its expenditure pattern in such a manner that there is effective administration, proper insfrastructural facilities, etc. It also provides subsidies and tax concessions to encourage production activity. Government also participates in production directly by opening public sector enterprises.

(2) Creating employment opportunities

Government creates employment opportunities directly by opening public enterprises and undertaking public works programmes like building of roads, bridges, government buildings, etc. Government of India has launched many employment generation schemes. Government creates employment opportunities indirectly also by pursuing policy of encouraging labour intensive industries through subsidies and lax concwdons. Government of India gives such tax concessions to small scale and collage industries in India.

(3) Ensuring stability in prices

Fiscal policy can play and actually plays an important role in avoiding fluctuations in prices. Undue rise in prices causes hardships to common man while undue fall in prices leads to fall in production and employment in the country. Government ensures some stability in prices, at least of essential goods for consumption and production, through fair price shops, keeping buffer stocks, giving fiscal incentives to raise production in the form of tax concession, subsidies, etc.

(4) Reducing inequalities of incomes

Only government intervention through deliberate fiscal measures can be helpful in reducing inequalities. On the taxation side government follows a progressive tax rate policy of taxing higher incomes and taxing production of goods consumed by the rich at a higher rates. On the expenditure side, government spends money so collected on welfare schemes meant for the poor,

(5) Regulating foreign trade and foreign exchange

Government encourages or discourages imports and exports by varying custom duties from time to time. For the past few years Government of India is following a policy of

liberalization of imports by lowering import duties with a view to step up production activity, attracting foreign investments, make the domestic market more competitive and encouraging exports. Liberalization of foreign trade also increases the flow of foreign exchange. This may ultimately he helpful in solving the balance of payments problems of the country.

Check Your Progress B

1. Distinguish between plan and non-plan expenditure of government.

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2. Define the concept of gross fiscal deficit as used in the central government's budget.

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3 Define fiscal policy.

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6.7 MEANING OF MONETARY POLICY

Monetary policy is the deliberate exercise of the monetary authority's power to induce expansions or contractions in the money supply with the objective of influencing investment, income and employment and maintaining price stability in general within the broad framework of economic policy objectives of government. The central bank of a country is the monetary authority of the country. In India Reserve Bank of India (RBI) is the central bank of the country. Each country has a central bank known by different names.

The objectives of monetary policy are nearly the same as that of fiscal policy. However the nature of measures adopted and the agencies responsible for implementation are different. Fiscal policy is operated by government while the monetary policy by the central bank (i.e. RBI). Fiscal policy involves changes in taxes and government spending, Monetary policy involves variations in money supply, interest rates, lending by commercial hanks etc.

To understand the meaning of monetary policy let us first explain the meaning of the concept of money supply and the institution of central bank.

6.7.1 What is a Central Bank?

Banking structure of a country comprises of central hank and the commercial banks. The commercial banks are engaged in accepting deposits from public and lending. In addition they provide many services to their depositors like cash withdrawls and transfer of funds from one bank to another etc.

The central bank is the supervisory hank over the commercial banks. It regulates the activities of these banks particularly the banking functions. If you have visited some banks You must have observed that all banks have nearly the same rules of making deposits and similar lending rates. It is because all such rules are framed by the RBI. The central bank, however, does not deal with the public directly. It deals with government and commercial banks only.

Following are the main **functions** of the central bank.

1. Sole authority to issue currency.
2. Looks after government accounts and advises government on economic matters.

3. Regulates deposits and lending activities of commercial hanks.
4. Lends money to the commercial bank in times of need (Lender of the last resort function).
5. Organizes inter-bank transfers (clearing house function).
6. Regulates the flow of foreign exchange.
7. Conducts research on economic matters.

6.7.2 Concept of Money Supply in India

The public holds money either in the form of cash or in the form of demand deposits with banks. We make payments either by paying cash or writing a cheque on the bank where we hold our deposits. **The sum total of money public holds and can be used for settling transactions, to buy and sell things and make other payments constitutes the money supply of a nation.** The general definition of money supply has the following components

Money supply	=	Notes and coins with public
		+ Demand deposits with commercial banks.

The above measure of money supply is a general measure and labelled as M_1. In India RBI follows four concepts of money supply M_1, M_2, M_3 and M_4. These are

M_1	=	Currency with the public + demand deposits of public with commercial banks.
M_2	=	M_1 + Post office saving deposits,
M_3	=	M, + Time deposits of public with commercial banks.
M_4	=	M, + Total post office deposits.

Out of these four concepts RBI generally uses M, and M,. The basic difference is that among bank deposits M_1 includes only demand deposits i.e. deposits withdrawable by writing cheques while M, includes all deposits i.e. also time deposits or fixed deposits etc.

6.8 INSTRUNIENTS OF MONETARY POLICY IN INDIA

Essentially the central bank relies on five instruments to influence money supply, interest rates etc. and in turn influences the course of entire economy. They are :

- Reserve ratios
- Bank rate
- Open market operations
- Margin requirements
- Moral suasion

The above list is not an exhaustive list. The central bank may adopt other measures as RBI does in India depending upon the purpose at hand. The first three are the general instruments because they influence the nation's money supply and general availability of credit. These are called **quantitative instruments.** The fourth and fifth are **selective** or **qualitative instruments.** These are aimed at affecting changes in the availability of credit with respect to particular (i.e. selective) sectors of the economy. Quantitative instruments are called 'quantitative' because they affect the total volume (or quantity) of money supply and credit in the country. Selective instruments are called selective because they are aimed at the movement of credit towards selective sectors of the economy. Let us explain each set of instruments.

6.8.1 Quantitative Instruments

I) ***Variations* in *reserve requirements***

The central hank makes it legally obligatory for the commercial banks to keep a certain

minimum percentage of deposits in reserve. They are of two types: a) cash reserves an liquidity reserves. **Cash reserves** are kept hy commercial hanks with central bank. **Liquidity reserves** are in the form of liquid assets such as cash, gold, securities, etc. a are kept by commercial hanks with themselves. Their minimum ratios as fixed by the 1 are called Cash Reserve Ratio (CRR) and Statulory Liquidity Ratio (SLR) in India.

How does it work? Suppose a commercial bank has a total deposit of Rs. 100 crores. Further suppose the CRR and SLR together come to 20 percent. It means that the bank has to legally keep Rs. 20 crores as reserves. It also means that the bank has the capac to grant loans upto Rs. 80 crores. Now if the minimum reserve requirements is 30 perc the bank's capacity to grant loans falls to Rs. 70 crores. So if the central bank wants contraction of credit in the economy it can raise legal reserve requirements.

2) *Bank rate*

The central bank lends money on interest to the commercial banks just as the commerci hanks lend money on interest to public. **The rate of interest charged by the central bank on their loans to commercial banks is called hank rate (or discount rate).**

Variation in bank rate influences credit conditions in the country. An increase in bank rat makes it more expensive for commercial banks to borrow. This exerts pressure to bring about a rise in interest rates (called lending rates) charged by the commercial banks on their lending to public. This leads to a general tightening of credit in the economy. The decrease in bank rite has the opposite effect and leads to general easing of credit in the economy. Inflationary conditions in the economy need tightening of credit while deflationary tendencies need general easing of credit.

3) *Open market operations*

These operations refer to the buying and selling of government securities by the central bank in the open market. When the RBI sells securities to the commercial banks or to the public the money flows out of commercial banks and into RBI. This reduces deposits of commercial banks and consequently their capacity to create credit. The buying of securities has the opposite effect leading to out flow of money from the RBI and into commercial banks leading to rise in deposits and credit creating capacity of these hanks.

6.8.2 Qualitative (or Selective) Instruments

Qualitative instruments influence the direction of credit rather than total volume of credit. Margin requirements and moral suasion are the two principal instruments. RBI uses more selective instruments in addition to these two.

1) Margin requirements

Commercial banks lend against security in the form of property, merchandise or financial instruments like shares, bonds, debentures etc. While lending against a security banks keep a margin as a safeguard against fluctuations in the market value. For example if the current market value of security is Rs. 10 lakhs, the bank may give loan ooly upto 80% of the value and keep a margin of 20% as a safeguard. The central bank uses this margin requirement as an instrument of regulation of credit. It has the power to fix the minimum margin. Higher the minimum margin less is the credit granted against a security. Higher or lower minimum margins may he fixed on selection basis to discourage or encourage borrowings.

2) Moral suasion

It implies the central bank exerting pressure on banks by using oral and written appeals to expand or restrict credit in line with its credit policy. No written rules are enforced. Banks are only advised and persuaded to discourage or encourage lending. Moral suasion is a psychological device which relies on personal talk and public opinion.

3) Ceilings on credit

To check undue expansion of credit in certain directions, the RBI puts ceiling on granting of credit for certain purposes. This instrument can also be used to ensure equitable flow of credit towards all sectors of the economy.

4) Discriminatory rates* of *interests

RBI is empowered to direct commercial banks to charge different interest rates for

granting credit to different sectors. Priority sectors are generally given loans at lower rates. The scope of the priorily sectors may be determined in accordance with overall economic policy of the government. At present agriculture, small industries, small traders, self-employed professionals, educated unemployed are some examples of priority sector.

6.9 OBJECTIVES OF MONETARY POLICY

The main objectives of monetary policy of RBI since the introduction of planning in India have been speeding up economic development and to control inflationary tendencies. Economic development is not a single objective hut a mix of many objectives like economic growth, employment, economic equality ctc. With the ever rising volume of foreign trade RBI regulates the flow of foreign exchange. These objectives are explained below.

1) ***Economic growth***

Economic growth implies rise in real income or output. It requires investment. The banking system is a big source of credit for investment. By regulating the flow of credit in the desirable directions the RBI contributes a lot to the economic growth of the country.

2) ***To control fluctuations in prices***

Both inflation and deflalion are not good for the health of the economy. Inflation causes hardships to consumers and causes decline in exports. Deflation causes unemployment and reduces real output. Money supply is an important factor causing inflation. More money in the hands of people means more demand. If the real output lags behind money supply the prices are bound to rise. The RBI plays a useful and important role in controlling the unrestricted growth of money supply through its monetary policy measures.

3) ***Employment***

More investment creates more employment opportunities. Bank loans are a very important source of financing investment in modern limes. The loan granting capacity of commercial banks is determined by the RBI's credit regulation measures, both quantitative and qualitative. RBI can raise this capacity by lowering reserve requirements, lowering bank rate, buying government securities from the market and so oa. In this manner RBI plays a very useful role in expanding employment opportunities in the country.

4) ***Economic equality***

Inequality in the distribution of incomes is an economic and social ill. All governments show determination in ensuring a more equitable distribution of income. RBI plays an important role in this respect. It tries to ensure adequate flaw of credit towards priority sectors like small scale and cottage industries and other less privileged sections of the society through selective credit controls. These sectors get loans at lower rates of interest and on easy terms. It blocks the unrestricted flow to the large industries by putting ceilings on bank credit.

5) ***Foreign exchange***

Fluctuations in exchange rates may adversely affect foreign trade. These may reduce home currency value of exports and increase value of imports. This may put exporters and importers into losses. RBI plays a very useful role in controlling these fluctuations. It puts certain conditions on inflow and outflow of foreign exchange and take other measures to ensure some stability in exchange rates. In India RBI is the sole authority of foreign exchange management.

6.10 ROLE OF RESERVE BANK OF INDIA

RBI plays three types of roles : 1) The traditional role that a central bank is expected to play; 2) the supervisory role i.e. regulation of the functioning of commercial banks in India and 3) promotional role i.e. helping the developmental process in the country. The three roles arc described below .

1) ***Traditional role***

Traditionally, like any other central bank in the world, RBI performs the following

functions :

- Sole authority to issue currency notes and coins in India.
- Handles all accounts of government.
- Advises government on economic matters.
- Regulates banking activities of commercial hanks who are required to keep a certain ratio of deposits as reserves with the RBI. In return RBI gives loans to these banks in times of need.
- Regulates lending hy commercial banks to keep a check on money supply,
- Regulates all foreign exchange transactions to ensure smooth flow of foreign exchange and stability in exchange rates.

2) Supervisory role

Although RBI was established in India in the year 1934 to perform the traditional function stated above, the Banking Regulation Act, 1949 gave RBI the powers of supervision and control over commercial hanks. These powers concern granting licenses to new banks, permission for opening more branches, framing rules for management and working etc. This role is to ensure smoothness in day to day working of commercial banks in India.

3) Promotional role

a) **Rural** credit

RBI takes direct interest in rural credit. Before 1982 it used to provide loans to the agricultural sector through cooperative institutions and state governments. Later this function was transferred by RBI to National **Bank** for Agriculture and Rural Development (NABARD) which was set up in 1982. After doing so RBI has not washed off his hands from its promotional function. It has opened up a new department called the Rural Planning and Credit Department to look after the problems of rural credit.

b) Industrial finance

The RBI has played a dominant role in setting up of credit institutions to finance industry. Main examples of such institutions are: Industrial Finance Corporation of India, State Financial Corporations, Industrial Development Bank of India, Industrial Credit and Investment Corporation of India.

c) Finance **of priority** sectors

The RBI directs commercial banks in India to give special attention to the credit needs of priority sectors like agriculture, small industries, small traders, self-employed professionals educated unemployed etc. It has designed schemes for these sectors implemented through the commercial banks.

Check Your **Progress *C***

Choose the correct alternative:

1. Monetary policy is operated hy
   a) Finance Minister
   b) Commercial banks
   c) Central bank
   d) Government of India
2. One of the following is not the instrument of monetary policy
   a) Moral suasion
   b) Margin requirements
   c) Open market operations
   d) Deficit financing

3. Bank rate is the rate of interest charged by the RBI on loans to
   a) Government of India
   b) Commercial banks
   c) Agricultural sector
   d) Industrial sector
4. The alternalive name of bank rate is
   a) Lending rate
   b) Open market rate
   c) Discount rate
   d) Discriminatory rate
5. One of the following is the qualitative instrument of RBI's monetary policy
   a) Discriminatory rates of interests
   b) Bank rate
   c) Cash reserve
   d) Open market operations
6. Monetary policy aims at regulating
   a) Money supply
   b) Availability of credit
   c) Flow of foreign exchange
   d) All the above
7. Advising government on economic matters is the following role of RBI
   a) Traditional
   b) Promotional
   c) Supervisory
   d) None of the above

6.11 LET US SUM UP

A macro economic policy refers to the deliberate measures taken at national level to regulale the functioning, growth and development of the economy and its sectors. Fiscal policy and monetary policy me the two crucial macro level policies.

Fiscal policy refers to the deliberate actions of government in its spending and taxing activities to achieve certain objectives. Government raises money through taxes; interest. dividends of public sector enterprises, external assistance and borrowings. Government spends money on normal running of government (revenue expenditure) and on acquisition of assets (capital expenditure), In the 1997-98 budget estimates about 3/4th of total expenditure is revenue expenditure and 1/4th is capital expenditure.

The main objectives of fiscal policy are : (1) promoting economic growth, (2) creating employment opportunities, (3) ensuring stability in prices, (4) reducing inequalities of incomes and (5) regulating foreign trade and foreign exchange.

Monetary policy is the deliberate exercise of the monetary authority's power to induce expansions or contractions in money supply. Monetary policy is operated by the central bank (RBI). The central bank is the apex bank and supervises over the commercial banks. It performs many functions like issuing currency, looking after government accounts, regulate flow of credit, regulate the flow of foreign exchange, etc.

The instruments of monetary policy are of two types : quantitative and qualitative. Reserve ratios, bank rate and open market operations are the quantitative instruments. Margin

requirements, moral suasion. ceilings on credit and discriminatory rates of interests are the qualitative instruments adopted hy the RBI. The main objectives of monetary policy are nearly the same as that of fiscal policy. These are : (1) economic growth, (2) control fluctuations in prices, (3) employment, (4) economic equality and (5) foreign exchange.

RBI plays three types of roles : traditional, supervisory and promotional. In its traditional role it performs the usual function a central hank is expected to play like issue of currency, handling government account?, regulating the activities of commercial banks, etc. In its supervisory role it has the power of granting licenses to new banks, permission of opening branches, etc. In its promotional role RBI takes direct interest in rural credit through NABARD; in industrial credit through IDBI, ICICI, IFC, etc and in priority sectors through commercial hanks.

6.12 (KEY WORDS

Macro policy : National level policy of government

Fiscal policy : Deliberate actions by government in its spending and taxing activities.

Plan expenditure :Expenditure of government on projects and schemes in the central plan.

Non-plan expenditure : Expenditure of government not included in plan.

Revenue expenditure : Expenditure on normal functions of government and does not lead to creation of assets.

Capital expenditure : Expenditure by government on acquisition of assets.

Gross fiscal deficit : Total expenditure of government less total receipts excluding borrowing and other liabilities.

Revenue deficit : Revenue expenditure less revenue receipts.

Budgetary deficit : Total expenditure less total receipts of government.

Primary deficit : Gross fiscal deficit less interest payments.

External assistance : Borrowings from foreign countries.

Monetary policy : Deliberate actions of monetary authority to influence money supply.

Cash reserve ratio : Ratio of deposits kept by commercial banks with central bank.

Liquidity reserve ratio : Ratio of deposits kept by commercial banks with themselves.

Bank rate : The rate of interest charged by the central bank on loans to commercial banks,

6.13 ANSWERS TO CHECK YOUR PROGRESS

C. 1. c), 2. d), 3. h), 4. c), 5. a), 6. d), 7. a).

6.14 TERMINAL QUESTIONS

1. Explain the meaning of the following :

   (a) Macro economic policy

   (b) Fiscal policy

   (c) Monetary policy

2. Explain the different ways of raising money by Government of India to finance its activities.

3. Distinguish between :

   (a) Plan and non-plan expenditures

   (b) Revenue and capital expenditures

4. State the different measures of deficit in the government's budget. How are these calculated?
5. What is gross fiscal deficit? How is it financed?
6. Explain the objectives of fiscal policy.
7. What is a central hank? State its functions.
8. What is money supply? State the different measures of money supply.
9. Explain the quantitative instruments of monetary policy.
10. Distinguish between quantitative and qualitative instruments of monetary policy. Explain qualitative instruments.
11. Explain the role of Reserve Bank of India.

Note: These questions will help you to understand the Unit better. Try to write answers for them, but do not send your answers to the University. These are for your practice only.

UNIT 7 CONSUMER PROTECTION

Structure

7.0 OBJECTIVES

After studying this unit, you should be able to:

- trace the evolution of consumer movement including consumer protection laws
- state consumer rights and responsibilities
- identify basic features of Consumer Protection Act, 1986, and
- explain the concepts of Monopolistic Trade Practices, Restrictive Trade Practices and Unfair Trade Practices under the Monopolies and Restrictive Trade Practices (MRTP) Act, 1969.

7.1 INTRODUCTION

The consumer movement exercises a considerable influence on the socio-economic environment of business. The imperfections in both the product and factor markets often result in some sort of exploitation of consumers. In a country like India, a large percentage of the masses are illiterate, poorly informed and have limited purchasing power. Most of the critical goods are always in short supply. Therefore the government has a significant role in safeguarding the interests of the consumer by promoting a climate of fair competition and influencing business decisions.

Some legislative measures have already been taken by the Central Government to safeguard the interests of the Indian consumer. There is a growing concern about consumer protection in India and we have a wide range of enactments to protect the consumer. In this unit you will study the evolution of consumer movement including consumer protection laws. You will also get acquainted with the rights and responsibilities of the consumer.

7.2 ΣΣEVOLUTION OF CONSUMER MOVEMENT INCLUDING CONSUMER PROTECTION LAWS

Consumer exploitation through unfair business practices is not a new phenomenon. In fact, the industrial revolution and a shift in population from rural areas to towns, and the anonymity of urban living gave plenty of scope for malpractices by business people.

In India, exploitation of consumers has assumed serious proportions. In view of the ever-increasing population and the need for goods and services on a large scale without a corresponding matching supply has created a situation of a near seller's market. The consumers have a very weak bargaining power and therefore cannot assert their rights. As a consequence, business people are tempted to follow certain practices which are unfair to consumers. Many manufacturers and traders indulge in making false claims about their foreign collaboration. The position on rendering of services to the public at large by business houses is no better. The consumers feel discouraged in persuing their complaints in civil courts due to disproportionate cost involved in redressal and the unduly long time involved in the court litigation.

In order to protect consumers from unscrupulous and unethical practices by business people, the Indian Government, from time to time, has enacted different laws. Some of these Acts are as follows:

1. Sales of Goods Act, 1930
2. The Drugs and Cosmelics Act, 1940
3. Prevention of Food Adulteration Act, 1954
4. The Essential Commodities Act, 1955
5. The Indian Standards Institution Certification Act, 1952
6. Agricultural Products and Grading and Marketing (AGMARK) Act, 1937
7. The Standards of Weights and Measures Act, 1956
8. Prevention of Black Marketing and Maintenance of Supplies of Essential Commodities Act, 1980

The above legislations are designed to offer'protection to consumers in respect of price, quality, service, information, safety, etc. However, much is desired in so far as their implementation is concerned.

The object and intent of almost all these enactments are mainly punitive, though some of them are preventive in nature. These Acts provide for the prosecution and punishment of those persons who violate the provisions conlained there in. The punishment is meant to operate as a deterrent against indulgence in malpractices in their dealings with consumers. None of these laws provide any direct relief to the consumer. He cannot seek any redressal against the offending trader, manufacturer or provider of service. Nor can he get compensation for loss suffered by him due to the defect in good or deficiency in service supplied to him.

The MRTP Act, 1969 gained the status of a specific consumer protection legislation with the amendments brought in il in 1984, Till 1984, there was no concept of unfair trade practice **(UTP)**. In spite of the change in the MRTP Act, 1984, a need was felt to have a more elaborate consumer protection legislation because of certain limitations in the Act. As a consequence, the Consumer Protection Act, 1986 was born. It is described as a unique legislation of its kind ever enacted in India to offer protection to the consumers.

In addition to enactment of laws by the governmenl, il is necessary to adopt measures to educate consumers to organise themselves for collective action. In this respect, the consumer movement has not made much progress in India. However, in United States of America, the consumer movement has developed on very sound lines. There, the consumer groups have realised their potential power and have become very aclive. They organise mass letter writing campaigns to the editors of newspapers, legislators and company presidents. They support consumer-oriented political candidates and attract media attention through demonstrations and picketing.

Consumer movement has spread internationally. It has become very strong in certain countries, such as Norway, Sweden, Netherlands, Australia and the United Kingdom.

During the last two decades, many international organisations have been active in the area of consuiner protection. The United Nations (UN) General Assembly adopted a set of guidelines on consumer protection in 1985. These guidelines include:

a) Physical safety of consumers
b) Protection of economic interest of consumers
c) Consumer's access to information needed to inake informed choices
d) Statutory measures for redressal of consumer grievances
e) Distribution of essential goods and services
f) Satisfactory product and performance standard
g) Fair business practices
h) International cooperation in the field of consumer protection

The developing countries iiicluding India too are not far behind in protecting the interests of their vast consuming population. In addition to the governmental agencies created under different legislations, there are about five hundred voluntary consumer associations functioning in India to protect the interests of consumers. Also, these associations ate engaged in creating awareness among consumers and taking up their cause not only before the various law-enforcing agencies but also the business houses. Even then, the consumer movement in India, as compared to developed countries, is still in its infancy. However it is making steady progress and is destined to achieve its laudable objective in near future. In this respect, the role of consumers cannot be overemphasised. In order to make the consumer movement successful, they must be aware of the existing consumer protection laws. In Tact, the laudable objectives of the legislation concerning consumer protection can only be achieved if consumers become fully conscious of their rights and are aware of availability to cheap and speedy remedies under the Act. They must understand that 'self-help is the best help'. We will study the rights and responsibilities of the consumers in section 7. 3 below.

7.3 CONSUMER RIGHTS AND RESPONSIBILITIES

It is important for us to know the different rights which have been given to consumers to enable them to protect themselves. These rights are not merely social codes but most of these rights now have legal sanction behind them. In other words, there are consumer protection laws and judicial decisions, which aim at upholding the consumer rights.

7.3.1 Consumer Rights

For a long time, certain basic rights of consumers have been recognised all over the world. In India the Consumer Protection Act, 1986 has extended a statutory recognition *to* some of the righls of consumers. Section 6 of the Act recognises the following six rights of consumers:

a) Right to safety
b) Right to be informed
c) Right to choose
d) Right to be heard
e) Right to seek redressal
f) Right to consumer education

Let us explain these rights in detail.

a) **Right to safety:** The right to safety means the right to be protected against marketing of goods and services which are hazardous to life and property. There are various risks involved in the consumption and use of products, such as electrical

appliances, drugs, pressure cookers etc. The products may cause even risk to life on the slightest lapse in their use.

b) **Right to be informed:** The right to be informed about the quality, quantity, potency, purity, standard and price of goods and services so as to protect the consumer against unfair lrade practices. He has got a right to have information in detail about the product, including its ingredients, date of manufacture, technical specifications etc. Also he must be told about the precautions to be taken in the use of the product and its proper maintenance and upkeep. He must he told about the strength, durability, serviceability and re-use value of the product. Also he has a right to know the side effects or after-effects (especially in the case of medicines), risks involved in the use of gadgets, toys for children, etc.

c) **Right to choose:** Right to be assured, wherever possible, access to a variety of goods and services at competitive prices. The consumer should be given the right to make evaluation of the alternative products and to buy the one which he chooses. He is not to be made the victim of high-pressure and aggressive salesmanship.

d) **The right to be heard: A** consumer is to be assured that his interest will receive due consideration at appropriate forums. This right includes the right to make protest against the defect in goods or deficiency in services provided to the consumer. The consumer can exercise this right either himself or through consumer's associations.

e) **The right to redressal:** It means the consumer has a right to a fair settlement of his just claims. It includes the right to receive compensation for misrepresentation or shoddy goods or deficient services,

f) **The right to consumer education:** It means the right to acquire knowledge and skills to be an informed consumer throughout his life. This education is needed for taking action to influence factors which affect consumer decisions. Also, this will help the consumer in protecting himself against fraudulent, deceitful and grossly misleading information, advertising, labelling, or such other practices. The education will inform him his legal rights and remedies under the different consumer protection laws.

7.3.2 Some Other Rights

In addition to the rights of consumers as given in Section 6 of the Consumer Protection Act, 1986, there are certain other rights also. There arc:

1. **The right to a healthy environment:** This right will help in enhancing the quality of life of the citizens. This right will ensure protection against environmental pollution, over which the individual consumer may not have any control.
2. **The right to satisfaction of basic needs:** He has a right to have access to basic and essential goods and services, adequate food, clothing, shelter, health care, education and sanitation.

7.3.3 Duties and Responsibilities of Consumers

It is a fact of social life that rights and duties are two sides of the same coin. As a consumer, you have rights, but there are duties also. As consumers, we have two types of duties: i) Duties with respect to the enforcement of rights and, ii) Duties in relation to other consumers. With reference to the first type of duties, it is to be noted that they art: inseparable from his rights. The duties and responsibilities related to the rights of consumers enumerated earlier are described below.

- It is the duty of every consumer to he careful while buying, about the quality of the goods. He is to ensure himself that the goods which he is buying are not dangerous and get assurance from the seller that they are free of defects, He may insist for the guarantee of safe products.
- The consumer should insist on getting all the information about the product or service before making a choice. This will help him in taking a decision whether to buy or not from a particular dealer, Also, this information will protect him from becoming a victim of high pressure selling techniques.

- The consumer should inspect a variety of goods before making a decision as to which one to buy. Of course, while taking a decision, he will compare weight, quality, price, durability etc. of goods of different manufacturers. No doubt, he can exercise this duty only in a competitive market where a variety of goods are available at competitive prices.
- The consumers should form consumers' associations. Every person must be aware of the consumer association in some way or the other, the consumer should not hesitate.
- Further, it is the duty of every consumer to make complaints to the appropriate authority for his genuine grievances. Many a time, his complaint may be of small value,.but its impact on the society, as a whole, may be very significant.
- Lastly, every consumer should acquire knowledge about different rights and duties enshrined in some law or the other. An informed consumer should help overcome ignorance of less informed or ill-informed consumers.

In addition to the duties enumerated above, the consumers have duties to other consumers. These are known as social and ecological responsibilities. The consumers should make responsible choices about their purchases and consumption in relation to society and the environment. Some of the problems which are responsible for irresponsible consumption are waste of natural resources and energy, and environmental pollution. **A** purchase of a sub - standard vehicle emitting too much smoke affects other's right to have a healthy environment. Hoardings of goods which are in short supply affects others to have them at the time when they need and at reasonable prices. Therefore, the consumers should remember that the choices they make as consumers affect .others, and also the environment.

Check Your Progress A

1. Name at least three laws which were enacted by the Government to protect consumers from unscrupulous and unethical practices of business people.

   i) ....

   ii) ....

   iii) ....

2. What is the object and intent of the above enactments? Are they meant to punish the defaulters or to pay compensation to the aggrieved party?

   ....

   ....

   ....

   ....

3. Mention at least three limitations of the 'above laws in that they cannot be of great help to consumers.

   ....

   ....

   ....

   ....

4. Is there any other method, in addition to enactment of laws, to protect the interests of consumers? If so, name it.

   ....

   ....

   ....

   ....

7.4 CONSUMER PROTECTION ACT, 1986

7.4.1 Introduction

In Section 7.1 we have enumerated a number of enactments which have a bearing either directly or indirectly on the protection of interests of the consumers. Almost all the enactments were meant to provide relief in specific situations only. None of them, for example, provided for rights of consumers, or for a separate judicial machinery to look into their complaints. The doctrine of caveat emptor (i.e., let the buyer beware) continued to be the governing rule. The helpless and harassed consumer did not really get any effective relief. The consumer remained the king only in the literature on economics. The seller/manufacturer/supplier of goods (and services) continued to be the leader. However, with the enactment of the Consumer Protection Act, 1986, the scenario has changed and the consuiners have begun to get some relief for their grievances against the business people.

7.4.2 Salient Features of the Consumer Protection Act, 1986

The salient features of the Consumer Protection Act., 1986 are as follows:

i) It aims to provide better and all-round protection to consumers.

ii) In terms of geographical application, it applies to the whole of India except the state of Jammu and Kashmir.

iii) It applies to all goods and services unless otherwise expressly notified by the Central Government.

iv) It is indeed a very unique and highly progressive piece of social welfare legislation and is acclaimed as the magna carta of Indian consumers. The Act has made the consumer movement really going and more powerful, broad-based, effective and people-oricnted. In fact, the Act has brought fresh hopes to the beleaguered Indian consumer. This is the only law which directly pertains to market place and seeks to redress complaints arising from it.

v) It provides effective safeguards to the consumers against different types of exploitation such as defective goods, deficient services and unfair trade practices.

vi) For enforcement of the rights of the consumer, the Act has created special consumer courts. The Act has made a provision for a three-tier consumer grievance redressal machinery with the District Forums at the base level, the State Commission at the middle level and the National Commission at the apex level. The state and national level bodies also function as appellate authorities. Also any decision of the National Commission can be challenged in the supreme court.

4 The cost of goods or services and compensation asked for is the criterion for filing the complaint with the above mentioned Redressal Forums. The District Forum has jurisdiction to entertain complaints where the amount involved is less than Rs. 5 lakhs. The State Commission has jurisdiction to entertain complaints if the amount claimed exceeds Rs. 5 lakhs but does not exceed Rs. 20 lakhs. The financial jurisdiction in the case of National Commission is where the claim exceeds Rs. 20 lakhs. These Redressal Forums constitute a quasi-judicial machinery to provide speedy and inexpensive relief to consumers.

The Redressal Forums are not trammelled by any technicalities or rules of complicated or elaborate procedure. They are merely to observe the basic rules of natural justice. No court fee or any other charge is to be paid in respect of any complaint or petition of appeal or revision, however high be the value of its subject matter.

vii) The Act provides a simple, speedy, and inexpensive redressal of consumer grievances relating to defective goods or deficiency in services.

viii) The complaint hy the consumers needs only to set out the grievances in a very simple form and furnish the name and address of the opposite party against whom the complaint is made. The complaint may be in the form of a letter lo the

concerned Redressal Forum and no formalities of any type would be insisted upon. Appearance before the Redressal Forum may be by the complainant himself in person or by an agent duly authorised by him. It is not obligatory for the parties to engage any advocate. Thus, it is a very simple and consumer-friendly legislation.

ix) The definition of the expression 'service' given in the Act is very comprehensive. In fact, it will take in service of any description rendered for consideration by any person or organisation including a public sector undertaking and or government agency. However, service rendered free of charge or under any contract of personal service are excluded. Thus the following services do not fall within its ambit: a) health services provided by government hospitals, b) civic amenities provided by municipal authorities.

All suppliers of goods and services, both in the private and in the public sector and the cooperative sector are covered by the Act.

x) The hallmark of the Act is that it has set a time-frame for the disposal of cases.

xi) The Act allows filing of 'class action' complaints on behalf of groups of consumers having common interests.

xii) The act also covers complaints relating to unfair trade practices. Thus, a consumer can directly protest to the District Forum against food adulteration, short weighing and overcharging. For example, the consumer can pick up a food sample from a shop, get it analysed by a chemist and file a complaint on that basis. It also provides for complaints against charging in excess of the price of a product fixed by law or rule and/or displayed on the packaged commodities.

xiii) To orgainse consumer resistauce further and educate them the Act also provides for the formation of Consumer Protection Councils in every state. These Councils do not have any legal authority under the Act but are meant to promote the cause of consumer protection and cover the six consumer rights as given in Section 6 of the Act,

7.4.3 Definitions of Certain Expressions used in the Act

A number of words and expressions have been used in the Act. These must be clearly understood by you so that you can comprehend the provisions of the Act.

Consumer: The Act provides relief to consumers only. Therefore, you must know the meaning of a consumer. Section 2(1) (d) defines the term consumer. Consumer means any of the following persons:

i) **A person who buys any goods for a consideration:** It also includes any other user of such goods when such use is made with the approval of the buyer. But it does not include a person who obtains such goods for resale or for any commercial purpose. However, the phrase 'commercial purpose' does not include use by a consumer of goods bought and used by him exclusively for the purpose of earning his livelihood, by means of a self-employment.

ii) **A person who hires or avails of any services for a consideration:** It also includes any beneficiary of such services other than the person who hires or avails of the services for consideration when such services are availed of with the approval of the first mentioned person. The consideration for the purchase of goods or hiring or availing of the services may have been paid or promised or partly paid and partly promised, or under any system of deferred payment.

Consumer dispute: According to Section 2(1) (c), 'Consumer dispute' means a dispute where person against whom a complaint has been made, denies or disputes the allegations contained in the complaint.

Defect: According to Section 2 (1) (c) , 'defect' means any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force or under any contract, express or implied, or as is claimed by the uader in any manner whatsoever in relation to any goods.

Deficiency: Corresponding to 'defect' in case of goods, the expression 'deficiency' is used in case of services. According to Section **2** (1) (g) deficiency means any fault,

imperfection, quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or otherwise in relation to any service.

District Forum: District Forum means a Consumer Disputes Redressal Forum established under Section 9 (a) by the State Government in each district of the state. The State Government may, if it deems fit, establish more than one District Forum in a district.

Goods: The term 'goods' under this Act has the saine meaning as under the Sales of Goods Act, 1930. Accordingly, 'goods' means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.

Manufacturer: Section 2 (1) (j) of the Act defines the term 'manufacturer' to mean any of the following persons:

i) A person who makes or manufactures any good or part there of.

ii) A person who does not make or manufac'ture any goods but assembles parts there of made or manufactured by others and claims the end product 'to be. goods manufactured by himself, But where a manufacturer dispatches any goods or part thereof to any branch office maintained by him, such branch office shall not be deemed to be manufacturer even though the parts so dispatched to it are assembled at such branch office and are sold or distributed from such branch office.

iii) A person who puts or causes to be put his own mark on any goods made or manufactured by any other manufacturer and claims such goods to be goods made or manufactured by himself.

National Commission: The expression 'National Commission' means the National Consumer Disputes Redressal Commission established under Section 9 (c) by the Central Government.

Person: The term 'person' includes:

i) a firm, whether registered or not;

ii) a Hindu Undivided Family

iii) every other association of persons whether registered under Societies Registration Act or not.

Restrictive Trade Practice: It means any trade practice which requires a consumer to buy, hire or avail of any goods or, as the case may be, services as a condition precedent for buying, hiring or availing of other goods or services.

Service: Section 2 (1) (0) provides that 'service' means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, boarding or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service.

State Commission: It means a Consumer Disputes Redressal Commission established in a state under Section 9 (b), by the State Government.

Trader: A 'trader' in relation to any goods means a person who sells or distributes any goods for sale and includes the manufacturer thereof. Where such goods are sold or distributed in package form, the expression 'trader' shall include the packer of those goods.

Unfair Trade Practice: Somewhat similar to the definition of unfair trade practice under the MRTP Act, 1969, we have one under the Consumer Protection Act, 1986. It is defined to mean a trade practice which, for the purpose of promoting the sale, use or supply of any goods or for the provision of any service, adopts any unfair method or unfair or deceptive practice including any of the following practices, namely:

1) The practice of making any statement, whether orally or in writing or by visible representation which:

    i) falsely represents that the goods are of a particular standard, quality, quantity, grade, composition, style, or model;

ii) falsely represents that the services are of a particular standard, quality or grade;

iii) falsely represents any re-built, second hand, renovated, reconditioned or old goods as new goods;

iv) represents that the goods or services have sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or services do not have;

v) represents that the seller or the supplier has a sponsorship or approval or affiliation which such seller or supplier does not have;

vi) makes a false or misleading representation concerning the need for, or the usefulness of, any goods or services;

vii) gives to the public any warranty or guarantee of the performance, efficiency or length of life of a product or of any goods that is not based on an adequate or proper test thereof. However, where a defence is raised to the effect that such warranty or guarantee is based on adequate or proper test, the burden of proof of such defence shall lie on the person raising such defence;

viii) makes to the public a representation in a form that purports to be

a) a warranty or guarantee of a product or of any goods, or services;

b) a promise to replace, maintain or repair an article or any part thereof or to repeat or continue a service until it has achieved a specified result;

c) if such purported warranty or guarantee or promise is materially nusleading or if there is no reasonable prospect that such warranty, guarantee or promise will be carried out;

ix) materially misleads the public concerning the price at which a product or like products or goods or services, have been or are ordinarily sold or provided;

x) gives false or misleading facts disparaging the goods, services or trade of another person.

2) Permits the publication of any advertisement, whether .in any newspaper or otherwise, for the sale or supply at a bargain price of goods or services that are not intended to be offered for sale or supply at the bargain price, or for period that is, and in quantities that are reasonable, have regard to the nature of the market and size of business, and the nature of advertisement.

3) Permits (a) the offering of gifts, prizes or other items with the intention of not providing them as offered or creating impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged in the transaction as a whole; (b) the conduct of any contest, lottery, game of chance or skill, for the purpose of promoting, directly or indirectly, the sale, use or supply of any product or any business interest;

4) Permits the sale or supply of goods intended to be used, or are of a kind likely to be used, hy consumers, knowing or having reason to believe that the goods do not comply with the standards prescribed by competent authority relating to performance, composition, contents, design, construction, finishing or packaging as are necessary to prevent or reduce the risk of injury to. the person using the goods.

5) Permits the hoarding or destruction of goods, or refuses to sell the goods or to make them available for sale or to provide any service, if such hoarding or destruction or refusal raises or tends to raise or is intended to raise, the cost of those or other similar goods or services.

7.4.4 No Relief to Consumers in the case of Unfair and Restrictive Trade Practices

In the case of these two practices, all that the district forum may order is to discontinue them, or not to report them.

7.4.5 Persons who can File a Complaint under the Act

The following categories of persons may file a complaint under the Act: (i) a consumer, (ii) any voluntary consumer association, registered under the Companies Act, 1956 or under any other law for the time being in force, (iii) the central goveniment, (iv) any state government, (v) one or more consumers, where there are numerous consumers having the same interest.

Check Your Progress B

1. Give at least three main features of the Consumer Protection Act, 1986.

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   ii) ....

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   iii) ....

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2. Give the financial jurisdiction for consumer complaints in the following cases:

   i) District Forum ....

   ii) State Commission..

   iii) National Commission ....

7.5 MONOPOLISTIC AND RESTRICTIVE TRADE PRACTICES (MRTP) ACT,1969

The MRTP Act, 1969 was brought on the statute with, a view to ensure that the operation of the economic system does not result in the concentration of economic power to the common detriment, and that there are no monopolies, and to prohibit monopolistic, restrictive and unfair trade practices, which are prejudicial to public interest. The Act was amended in 1991. In this unit, we shall focus our attention on monopolistic, restrictive and unfair trade practices,

7.5.1 Monopolistic Trade Practices (MTP)

It is common knowledge that monopolistic position leads to certain practices which are against the interesl of the consumers The Act defines it as a practice which has, or is likely to have the effect of

i) maintaining price at an unreasonable level by limiting, reducing or otherwise controlling the production, supply or distribution of goods of any description or the supply of any services or in any other manner;

ii) unreasonably preventing or lessening competition in the production, supply or distribution of any goods or in the supply of any services;

iii) limiting technical development or capital investment to the common detriment or allowing the quality of any goods produced, supplied or distributed, or any service rendered in India to deteriorate;

iv) increasing unreasonably (a) the cost of production of any goods, or (b) charges for the provision, or maintenance of any services;

v) increasing unreasonably (a) the price at which goods are, or may be, sold or resold, or the charges at which the services are, or may be, provided, or (b) the profits which are or may be derived hy the production, supply or distribution (including the sale or purchase) of any goods or hy the provision of any services;

vi) preventing or lessening competition in the production, supply or distribution of

any goods or in the provision or maintenance of any services by the adoption of unfair method or unfair or deceptive practices.

The power to pass remedial orders as regards MTP vests in the Central Government. But it can pass orders only on the basis of a report submitted by the MRTP Commission after investigation into the alleged monopolistic trade practices.

7.5.2 Restrictive Trade Practices (RTP)

Another objective of the MRTP Act is to prohibit restrictive trade praclices. The Act defines a RTP to mean a trade practice which has or may have the effect of preventing, distorting or restricting competition in any manner; and in particular:-

i) Which tends to obstruct the flow of capital or resources into the stream of production, or

ii) Which tends (a) to bring about manipulation of prices or conditions of delivery, or (b) to affect the free flow of supplies in the market relating to goods or services in such manner as to impose on the consumers unjustified costs or restrictions,

The Act regulales RTP in three ways:

a) registration of agreements concerning restrictive trade practices.

b) restraining persons from indulging in restrictive trade practice by the MRTP Commission after holding an inquiry.

c) prohibiting re-sale prices.

Section **33** provides that every agreement falling within one or more of the categories mentioned there in shall he deemed to be an agreement relating to restrictive trade practice and will be subject to registration with the MRTP Commission.

Section **37** empowers the MRTP Commission to inquire into any restrictive trade practice whether the agreement, if any, relating to the practice has been registered under Section 35 or not.

Section **38** provides a number of gateways under which if the MRTP Commission is satisfied, the restrictive trade practice might be permissible.

The Act has made separate provisions for another restrictive trade practice, known as re-sale price maintenance. Re-sale price maintenance, in relation to sale of goods of any description, means any price notified to the dealer or otherwise published by or on behalf of the supplier of the goods in question as the price or minimum price which is to bc charged on, or is recommended as appropriate for a sale of that description or any price prescribed or purporting to be prescribed for that purpose by any contract or agreement between the wholesaler or retailer and any such supplier.

7.5.3 Unfair Trade Practices (UTP)

Section 36A provides that an unfair trade practice means a practice which for the purpose of promoting the sale, use or supply of any goods or for the provision of any services, adopts any unfair method or unfair or deceptive practice including the practices mentioned below. The following are the unfair trade practices:

i) Misleading advertisement and false representation.

ii) Bargain sale, hail and switch selling.

iii) Offering gifts or prizes with the intention of not providing them and conducting promotional contests.

iv) Non-compliance of product safety standards.

v) Hoarding or destruction of goods.

Cheek Your Progress C

I. What is the objective of the MRTP Act, 1969?

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2. What are the ways in which the MRTP Act regulates RTP?

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3. List out few Unfair Trade Practices (UTP) mentioned'under the MRTP Act.

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4. Distinguish between "monopolistic' and ,'restrictive' trade practices..

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7.6 LET US SUM UP

The consumer movement exercises a considerable influence on the socio-economic environment of business. A strong consumer movement is the sign of a healthy household sector in an economy.

In a country like India, a large percentage of the masses are illiterate, less informed and have limited purchasing power, and most of the critical goods are always in short supply. Therefore the government has a significant role in safeguarding the interests of the consumer by promoting a climate of fair competition.

The Central Government has already taken certain legislative measures to safeguard the interests of the consumer. There is a wide range of anactments which operate to protect the consumer. Some of these Acts are: the Sales of Goods Act, 1930; the Drugs and Cosmetics Act, 1940; Prevention of Food Adulteration Act, 1954; the Essential Commodities Act, 1955, the Indian Standards Institution Certification Act, 1952; the Standards of Weights and Measures Act, 1956,

Many of the above mentioned laws have, however, not proved to be effective due to their faulty implementation. These enactments fall shorl of providing adequate safeguards to the consumer interest as they cover specific products or malpractices. The protection available to the consumer under these legislation is not adequate. Thus the consumer is subjected to a number of unfair practices indulged in by the suppliers of goods and services.

Legislation, like the MRTP Act, has not really protected the vast majority of consumers. It is government's commitment, alongwith consumers' awareness, which can promote a strong and healthy cqnsumer movement in our country.

7.7 KEY WORDS

Consumer dispute: A dispute where person against whom a complaint has been made, denies or disputes the allegations contained in the complaint.

Defect: 'Defect' means any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to he maintained by or under any law for the time being in force or under any contract, express or implied, or as is claimed by the uader in any manner whatsoever in relation to any goods.

Deficiency: Corresponding to 'defect' in case of goods, the expression 'deficiency' is used in case of services. According to Section 2 (1) (g) deficiency means any fault. imperfection, quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or otherwise in relation to any service.

District Forum: Consuiner Disputes Redressal Forum established under Section 9 (a) by the State Government in each district of the state. The State Government may, if it deems fit, .establish more than one District Forum in a district.

Goods: The term 'goods' means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.

Restrictive Trade Practice: It means any trade pracuce which requires a consumer to buy, hire or avail of any goods or, as the case may be, services as a condition precedent for buying, hiring or availing of other goods or services.

Service: Section 2 (1) (0) provides that 'service' means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, boarding or lodging or hoth, housing construction, entertainment, amusement or the purveying of news or other information, but docs not include the rendering of any service free of charge or under a contract of personal service.

State Commission: It means a Consumer Disputes Redressal Commission established in a state under Section 9 (b), by the State Government,

Trader: A 'trader' in relation to any goods means a person who sells or distributes any goods for sale and includes the manufacturer thereof. Where such goods are sold or distributed in package form, the expression 'trader' shall include the packer of those goods.

7.8 TERMINAL QUESTIONS

1. How the grievances of the consumers are sought to be protected under the Consumer Protection Act, 1986?

2. Define the following terms as per the Consumer Protection Act, 1986:

   a) Consumer

   h) Consumer dispute

   c). Defect

   d) Service

   e) Trader

   f) Restrictive trade practice

3. Who can file a complaint under the Consumer Protectiou Act? What sort of complaint may be lodged under the Act?

4. Examine the basic rights of a consumer under the Consumer Protection Act, 1986.

5. State the objectives of the MRTP Act, 1969. What do you understand by the term 'monopolistic trade practice' as used under the above Act?

6. Discuss how an aggrieved party can seek compensation for the loss suffered on account of restrictive trade practices carried out by an unscrupulous manufacturer.

Note: These questions will help you to understand the Unit better. Try to write answers for them, but do not send your answers to the University. These are for your practice only.

SOME USEFUL BOOKS

Francis Cherunilam, *Business Environment*, Himalaya Publishing House, Mumbai.

George Steiner, *Business and Society*, Macmillan, New York.

Indira Gandhi National Open Universily, Course Materials – MS-3 : *Economic and Social Environment.*

Tandon, B.B. & Tandon, K.K., *Indian Economy*, Tata McGraw Hill, New Delhi.

UNIT 8 INDUSTRIAL POLICY

Structure

8.0 OBJECTIVES

After studying this unit, you should be able to:

- describe the role assigned to the public sector in the industrialisation of the economy
- define the role the private enterprise was ,expected' to play in this process
- explain essential features of the New Industrial Policy and how is it expected to give a boost to industrial development programmes in the country
- show that privatisation and public sector reforms are built-in ingredient of any reforms programme in our country.

8.1 INTRODUCTION

There are several aspects of 'economic policy which' affect industrial investment and protluclion. There is, first, industrial licensing policy which regulates the setting up of new industrial undertakings and their expansion. Second, here is policy concerning the coatrol of monopolies and economic concentration. Third, there is policy regarding technology import, Closely allied to technology and impost policy is the policy regarding the import of capital goods, components and raw materials. Finally, there is a whole range of financial and fiscal policies which pertain to the provision of industrial finance, development of the capital market, as well as fiscal incentives/disincentives to investment and production.

The basic objective of this unit is to acquaint you with the policy framework within which the industrial structure of the Indian economy has developed over the last five decades,

since independence. In this unit you will study the evolution of industrial policy in India, the New Industrial Policy and the public sector reforms and privatisation.

8.2 EVOLUTION OF INDUSTRIAL POLICY

Evolution of industrial policy in India can he traced wilh a hrief review of the industrial scene as it obtained at the time of independence. The industrial scene in India at the time of independence was characterised hy the following features:

1. The industrial sector was extremely underdeveloped.
2. There was great resentment at the lack of infrastructure industries.
3. The lack of government intervention in favour of the industrial sector was seen as an important cause of underdevelopment.
4. Export-orientation had heen seen as heing against the country's interests.
5. The structure of ownership was highly concentrated.
6. Technical and managerial skills were in short supply.

As a result, the national consensus was that economic sovereignty and economic independence lay in rapid industrialization including particularly the promotion of industrial infrastructure. The stage was set for the practice of economic and industrial' policies which emphasised rapid industrialisation hut through an activist and interventionist role of the government.

8.3 INDUSTRIAL POLICY RESOLUTION (IPR) 1956

Immediately after Independence, it was considered desirable hy the government to announce its attitude towards private capital and to define the scope of private participation. This aimed at resolving all uncertainties that would have worked as constraints on industrial growth in the economy. This announcement tdok the form of the Industrial Policy Resolution (IPR) 1948. The main objectives of the IPR 1948 were:

1. the development and regulation of industrial investments and production according to plan priorities and targets;
2. the protection and encouragement of small industries;
3. the prevention of concentration of ownership of industries; and
4. balanced economic development of different regions in the country in order to reduce disparities in the level of development.

The Government of India was empowered to pursue these ohjectives under the Industries (Development and Regulation1 Act, 1951.

8.3.1 Changes Since IPR 1948

A number of important developments had taken place in India after adoption of the IPR 1948. These necessitated a new statement on industrial policy.

Among these developments. the more important were as follows:

1. New Constitution of India which guaranteed certain Fundamental Righls and provided for Directive Principles of State Policy.
2. Completion of the First Five Year Plan and commencement of the Second Plan.
3. Acceptance hy the Parliament of the socialistic pattern of society as the objective of the social and economic policy.

8.3.2 Objectives of the IPR 1956

To give effect to the abovesaid changes, the IPR 1956 was formulated. The IPR 1956 aimed to pursue the following objectives:

i) development of heavy and machine-building industries

ii) expansion of the public sector

iii) establishment of a large and growing cooperative sector

iv) encouragement to the diffusion of ownership and management of the private sector.

8.3.3 Basic Features of IPR 1956

Besides reiterating the already declared goals of promoting cottage and small industries, maintenance of industrial peace, reduction in regional disparities and the need for establishing proper managerial and technical cadres, the most distinctive feature of the IPR 1956 was the classification of the entire industrial sector in three schedules. These are :

1. **Schedule A** : It contained 17 industries-all new units in these industries, except those where establishment in private sector has already been approved, would he set up only by the state.
2. **Schedule B** : It contained 12 industries. Such industries were to be progressively State owned.
3. **Schedule C** : All other industries were left to be included in this schedule. The future development of these industries would he the joint responsibility of the government and the private enterprise.

8.3.4 Industrial Licensing

To give effect to the industrial policy, the system of industrial licensing had been adopted. An industrial license is an important instrument of State policy. A license is a written permission from the government to an industrial unit to manufacture goods specified in the permission letter. A license to run an industry also specifies such particulars as the location of the plant, goods to he produced, the capacity of the unit, period within which the industrial capacity is to be established, etc.

The legislative framework for the industrial licensing came to be embodied in three different Acts passed at different times. These arc :

1. Industries (Development and Regulation) Act, 1951
2. Monopolies and Restrictive Trade Practices Act, 1969
3. Foreign Exchange Regulation Act, 1973

In addition, a number of other executive controls have been adopted, e.g., i) Capital issues control, ii) Import and export control, iii) Commodity control. iv) Financial and credit control, v) Location, environment and labour legislation.

8.3.5 Review of Industrial Policy

The IPR 1956 provided the framework within which the policies having an impact on the industrial structure of the Indian economy had been formulated, The industrial policy framework however has been continuously 'monitored and revalued. The policies have been reoriented from time to time.

The process of reorientation gathered momentum after mid-eighties. The government set up several expert committees to examine its fiscal, monetary industrial and trade policies. The general outcome of their findings and recommendations can perhaps he expressed as follows:

- Accelerated growth will require' increased imports
- It is ahsolutely necessary 'to increase exports to pay for increased imposts
- It is necessary to enhance the competitive advantage of exports
- This requires changes in economic policies.

In view of these recommendations the New Industrial Policy (NIP) was announced on July 24, 1991. We will discuss the NIP in detail in Section 8.4,

Check Your Progress A

1. Describe five major features of the industrial scene as it obtained at the time of independence.

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2. What major changes had taken place after the announcement of the IPR 1948? Mention briefly.

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3. What were the Lhree schedules mentioned in IPR 1956?

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4. What were the primary suggestions of the different expert committees for accelerated economic growth'!

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8.4 NEW INDUSTRIAL POLICY 1991

The basic philosophy of the New Industrial Policy (1991) has been summerised as 'continuity with change'. It follows the policy of sell-reliance hut with greater stress on ability to pay for imports from exports. It also recognised the need for development of indigenous technology and manufacturing capabilities to world standards. The Industrial Policy 1991 assigned importance to a) industrialisation of backward areas through infrastructure development and b) promotion of small scale industry through technology upgradation and efficiency improvement. The Policy underlined the significance that public sector units have to he run on business lines as envisaged in IPR 1956.

8.4.1 Objectives

The New Industrial Policy seeks to achieve the following objectives:

1. To consolidate the strengths built up during the last four decades of economic planning and to build on the gains already made.
2. To correct the distortions or weaknesses that may have crept in the industrial structure as it has developed over the last four decades.
3. To maintain a sustained growth in the productivity and gainful employment
4. To attain international competitiveness.

8.4.2 Policy Measures

In pursuit of the above objectives, policy initiatives have been taken in a number of areas. Thme can be separately identified as follows:

1. Industrial Licensing Policy

   i) Industrial Licensing has been abolished for all projects, except for a small list of 9 industries. These are coal and lignite. petroleum, alcoholic drinks, sugar, cigars and cigarettes, electronic, aerospace and defence equipment. industrial explosives, hazardous chemicals, and drugs and pharmaceuticals.

   ii) Only 5 industry groups where security and strategic concerns predominate are reserved exclusively for the public sector.

   iii) In projects where imported capital goods are required, automatic clearance will he given where foreign exchange availability is endured through foreign equity.

   iv) In locations other than cities of more than 1 million population. there will he no requirement of obtaining industrial approval from the central government except for industries subject to industrial licensing.

2. Foreign Investment

   i) Approval will he given for direct foreign investment up to 51 per cent equity in high priority industries.

   ii) To provide access to foreign equity holdings up to 51 per cent will be allowed for trading companies primarily engaged in export activities.

   iii) A special empowered Board would be constituted to negotiate with a number of large international' firms and approve direct foreign investment in select areas.

3. Foreign **Technology** Agreements

Automatic permission will he given for foreign technology agreements in identified high priority industries.

4. **Public** Sector

   i) Portfolio of PSUs will he reviewed with a view to focus the public sector on strategic, high tech and essential infrastructure.

   ii) PSUs which are chronically sick will he referred to the Board for Industrial and 'Financial Reconstruction (BIFR).

   iii) Government's shareholding in the PSUs will be disinvested.

5. MRTP Act

   i) The MRTP Act has been amended to remove the threshold limits of assets in respect of MRTP companies.

   ii) Emphasis will he placed on controlling and regulating monopolistic, restrictive and unfair trade practices.

8.4.3 Evaluation of the New Industrial Policy

1, The New Industrial Policy has overnight altered the industrial scenario in India. In extent and scope, the industrial policy is a watershed which will he as significant for the economy as the IPR 1956 which pave primacy to the role of the stale in industrial development. Henceforth, industrial enterprise. efficiency and the market will be the determinants of industrial advances.

2. The delicensing of a host of industries and the abolition of all registration schemes will enable entrepreneurs to quicken decision-making and move quickly to seige business opportunities.

3 The other area in which the government has taken a giant leap, breaking new and hitherto sacred ground, is with respect to foreign participation in Indian companies, both in industry and external trade. The liberalisation of rules relating to direct foreign investment, permitting 51 per cent and even 74 per cent equity in a wide range of industries on a generalised basis, the easier fecilitation of foreign technology agreements, and other related measures constitute historic landmark in the evolution of industrial policy in India.

4. Another important component of this, the scrapping of the policy on phased manufacturing programmes, is also to be welcomed because it does away with the case-by-case approach, and because suitable financial incentives for indigenisation have been built into the external value of the rupee, and the trade policy.

5. On the public sector. the policy quite correctly evaluates the role of the public sector in the economy. The public sector has entered areas in which no commercial logic is served nor is there a broader welfare mechanism that is being met. Therefore, it makes sense to disinvest the government's holdings in these industries and let commercial logic dictate their functioning.

Check Your Progress B

1. Mention the main features.of the New Industrial Policy relating to industrial licensing system.

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2. Mention the main features of the New Industrial Policy relating to foreign collaboration and investment.

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8.5 PUBLIC SECTOR REFORMS AND PRIVATISATION

New Industrial Policy heralds a new approach to public enterprises. It seeks to restrict the role of public sector to provision of physical and social infrastructures and to areas where security and strategic considerations predominate. It instead seeks lo provide a more open environment to private capital and enterprise. In other words, New Industrial Policy seeks to promote privatisation of the economy.

8.5.1 Meaning of Privatisation

Privatisation refers to any process that reduces the involvement of the state/public sector in economic activities of a nation.

The privatisation process in a mixed economy such as of India includes:

1. Denationalisation. i.e., the transfer of the state ownership of productive assets to the private sector.
2. Entry of private sector industries into the areas exclusively reserved for the public sector.
3. Transfer of management and control of public sector undertakings and departments to the private sector.
4. Limiting the scope of the public sector or no more diversification of existing PSUs.

8.5.2 Arguments for Privatisation

The move towards privatisation has gained currency due to following arguments:

1. The budgetary deficits in India are increasing considerably, These leave little scope for new investment by the state.

2. The non-development, non-plan expenditure of the state is increasing steadily. As a result, scarce and valuable resources have to he diverted for financing the ever-growing consumption expenditure of the government.
3. The incremental capital-output ratio for the economy has been increasing plan after plan. This ratio for public sector is even higher and exhibits a tendency of further increase.
4. Dismal performance of PSUs has led to a situation where these enterprises have become a drain on the national economy.

8.5.3 Gains from Privatisation

Privatisation is expected to deliver following advantages to the economy.

1. To improve efficiency and performance by introducing profit-oriented decision-making process,
2. To reduce governmentís interference and increase the freedom, and speed of decision-making;
3. To promote private sector culture by introducing competition.

In other words, privatisation is seen as promoting both economic efficiency and technical efficiency.

8.5.4 Move Towards Privatisation

In pursuance of the declared policy, certain steps have been taken towards

1. Permitting the entry of the private corporate sector in such core areas as steel; telecommunications and power;
2. No fresh budgetary support to PSUs;
3. Disinvestment of equity, of select PSUs.

8.5.5 Restructuring of PSUs

Along with privatisation, what is equally important is that the PSUs are restructured to face the growing competition from the private corporate sector and the MNCs.

The focus of restructuring of PSUs has to be on the following areas:

1. **Corporate governance :** A code of corporate governance will have to be put in place so that the enterprises would be run in the interest of its shareholders including minority shareholders.
2. **Financial restructuring :** Financial restructuring is required not only in loss making PSUs but may be needed for other PSUs where the capital structure may be skewed in favour of either debt or equity,
3. **Business and technological restructuring** : It is pertinent to determihe what are the core competencies of each PSU and decide on the relative importance of each business. Business restructuring may involve living off businesses which are no longer attractive from the view point of returns or are a drag on other profitable ventures. In addition, technological upgrading or restructuring may he required to either sustain or improve the competitive position of technology driven PSUs.

Check Your Progress C

1. What is meant by privatisation?

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2. State ally two arguments in Favour of privatisation.

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3. In your opinion, what are the advantages from privatisation to the economy?

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8.6 LET US SUM UP

In this unit we have traced the evolution of industrial policy since independence. Although the first formal statement on policy was made in the year 1948, a well-formulated policy declaration took the shape of the Industrial Policy Resolution 1956. This resolution sought to pass on the commanding heights of the economy to the slate. The private sector was seen only in a supporting role. The New Industrial Policy 1991 marks a turning policy. The new policy seeks to give principal role to private capital and enterprise, whereas the state is seen only in a supportive role. In pursuance of this policy, concerned moves have been made towards privatisation of the economy. But along with privatisation, what is equally more important is that the public sector undertakings are restructured. Restructuring of PSUs will enable them face better the challenges of liberalisation, privatisation and globalisation.

8.7 KEY WORDS

Infrastructure : The structure of supporting services requited for production sectors.
Industrial Policy : Covers all those aspects of policy framework that affect industrial investment and production.
Monopolistic Trade Practices : Trade practices which have the effect of preventing or distorting competition.
Restrictive Trade Practices : Trade practices which impose on the consumer unjustified costs or restrictions.
Unfair trade practices: Trade practices that cause loss or injury to the consumer.
Liberalisation : Policy whereby different controls and restrictions placed on industry are sought to be removed.
Protection : Policy whereby domestic producers are protected against foreign competition by raising of tariff walls and non-tariff barriers.
Commercial'Policy : Rules adopted by a country for the conduct or regulation of its foreign trade and payments.

8.8 TERMINAL QUESTIONS

1. Trace the evolution of Industrial policy in India.
2. What is Industrial Policy? State the main features of Industrial Policy Resolution (IPR), 1956.
3. "The New Industrial Policy marks a sharp departure from the previous industrial policies" Comment.
4. What is meant by privatisation'?Analyse the changing trends in the light of privatisation.

Note: These questicns will help you to understand the Unit better. 'Try to write answers for them, but do not send your answers to the University. These are for your practice only.

UNIT 9 INDUSTRIAL SICKNESS

Structure

9.0 OBJECTIVES

After studying this Unit you should be able to:

- describe the nature of industrial sickness
- specify the indication of sickness in industrial units
- identify the causes of sickness
- explain the nature of Government Policy with respect to industrial sickness in India
- describe the role of the Board for Industrial and Financial Reconstruction (BIFR)
- appreciate the provisions of the Sick Industrial Companies (Special Provisions) Act, 1985

9.1 INTRODUCTION

In the preceding unit of this Block, you have come to know about the evolution of Industrial Policy in India, the reformist policies adopted in 1991, and the nature of public sector reforms being pursued by Government along with the divestment of shares of public enterprises. Over the last two decades, the problem of industrial sickness has become increasingly more serious considering the number of units falling sick and the resulting implications. This unit aims to make you familiar with the nature and causes of industrial sickness, and the remedies which have been applied to stall the problem.

9.2 NATURE OF INDUSTRIAL SICKNESS

The use of the word 'sickness' in relation to any industrial unit generally underlines its malfunctioning. In other words, when any industrial unit is said to be sick, it means to convey that all is not well with the unit, its operational results are unsatisfactory, and its

survival is doubtful. Ultimately, a sick unit is likely to close down if it is not revived by adopting appropriate measures.

As such, industrial sickness is not an unnatural phenomenon. In the normal course of existence, some industrial units are likely to develop symptoms of ill-health that are cured and the units are revived. When such symptoms are ignored, neglected or overlooked, sickness spreads and cripples all activities and the unit goes bankrupt and closed down. However, if the incidence of sickness tends to he high, the consequences may assume serious proportions.

To understand the nature of industrial sickness, we must recognise that sickness can be spotted only on the basis of symptoms or indicators, which may not be objectively identifiable, nor always amenable to measurement. It may he difficult also to correctly interpret the symptoms. Secondly, one cannot draw a clear line of demarcation between perfectly healthy units and totally sick units. The degree of intensity of sickness also varies. It may he of a mild nature or more serious. Thirdly, it is important to note that an enterprise does not become sick all of a sudden. There is a time lag before actual sickness overtakes an enterprise.

In view of the above, it may he useful to distinguish between symptoms which are of the nature of forewarnings and those which indicate actual sickness. When danger signals are noticeable in the state of health of an enterprise, it may he regarded as **incipient sickness,** meaning thereby that the unit concerned must recognise the signals as forewarnings preceding actual sickness. Naturally, the criteria or indicators used to ascertain the emergence of incipient sickness will he different from those to identify actual sickness.

According to information available from the Reserve Bank of India till the beginning of 1997, there were more than 2,70,000 sick industrial units in India. Small-scale units accounted for 99 per cent of this number. However, of the total outstanding bank credit to sick industrial units, the share of small-scale units was only around *25* per cent. In other words, the number of medium and large-scale sick units, which was hardly 1 per cent of the total. enjoyed 75 per cent of the total outstanding bank credit to sick units. Thus the incidence of industrial sickness is very high in the small-scale sector. The 'indicators' of sickness may also he somewhat varied in the case of small-scale industrial units. Let us examine these indicators in detail in the following section.

9.3 INDICATION OF SICKNESS

As stated earlier, whether ally industrial unit is sick or suffering e o n ill-health can be known only on the basis of symptoms, indicators or warning signals. In practice, two or more indicators are generally taken into account to identify sickness. Fiuancial indicators are widely used because operational flaws are clearly reflected in the financial results of a firm. These indicators are:

- profitability, earnings, revenue losses
- cash losses
- falling current ratio (ratio of current assets to current liabilities)
- failure to pay loan instalments
- worsening of debt-equity ratio (ratio of long-term debts to owners' funds)
- declining net worth (total of owner's capital and free reserves)
- declining dividend rate, skipping dividend payment.

Let us consider the use of these indicators. According to the definition adopted by the Reserve Bank of India, an industrial unit is considered to be sick if i) it has incurred cash loss for one year, ii) it is likely to continue to incur cash losses in the current year as well as the following years, iii) it has a current ratio of less than 1:1, and there is worsening of its debt-equity ratio. The emphasis here is on cash losses; other financial ratios are meant to be used as supporting tests.

Again, under the Sick hidustrial Companies (Special Provisions) Act, 1985, as amended in 1993 *an* industrial company is sick, if it has been in existence for at least five years, and

has at the end of any financial year accumulated losses equal to or exceeding its entire net worth. To enable remedial measures to be initiated at an early stage, indicators have been specified to identify 'weak' units, or potentially sick units. These are units which had, at the end of any accounting year, accumulated losses equal to or more than 50 per cent of their peak net worth in the immediately preceding four years. This is also regarded as an indication of any small-scale industrial unit being sick. Where financial details are not easily available, sickness is taken to be indicated hy continuous default in the payment of interest or instalment on loans for one year, and persistent irregularities in maintaining credit limit with banks.

For small-scale industrial units, capacity utilisation of less than 50 per, cent of the highest achieved during the preceding five years is considered to he an indication of **incipient sickness.** Other indications may be revenue losses, problem of short-term liquidity etc. The indicators of **actual sickness** are: erosion of net worth hy 50 per cent or more default in payment of loan instalments, or closure of the unit for 6 months or more during the previous year.

Incipient sickness of any industrial company may he indicated at an early Stage by reduced dividend payment or skipping of dividend which is likely to continue. Changes in the company's share prices on the stock exchange may he a supporting indicator. Default in payment of loan instalments is invariably found to occur as a consequence. Hence all lending institutions consider failure to pay institutional dues as an indicator of incipient sickness. The financial institutions consider a unit as sick when it is found to have sustained losses continuously for at least two years, and as per the latest balance sheet, the accumulated losses have exceeded 50 per cent of the paid-up capital and reserves.

9.3.1 Limitations of Financial Indicators of Sickness

Some analysts have contended that financial symptoms of sickness suffer from two main flaws. **First,** financial information about companies are available to the public in the annual reports which are neither adequate nor reliable. as there is considerable scope for discretion in adopting accounting principles and standards. **Second,** financial indicators reveal ill-health when sickness has already set in, and hence are not well suited for detecting incipient sickness. In view of the ahove, the necessity of identifying management deficiencies and non-financial factors has been emphasised for detecting early warnings of sickness.

9.3.2 Predictability of Sickness Based on Early Warning

Attempt to underline the significance of early warning signals and incipient sickness has also drawn attention to the question of predictability of industrial sickness,' Obviously, if sickness could be predicted well in advance. the incidence of actual sickness might he much less, Let us examine the question with particular reference to the quality of management and relevant non-financial [actors.

According to some writers, who looked into the causes of corporate failures in the USA and UK, the most significant management defects were: (i) Autocratic style of the Chief Executive, (ii) Docile Board of Directors, (iii) Weak finance function at the Board level, (iv) Unbalanced Board, (v) Poor quality of management below Board level, (vi) Lack of controls, and (vii) Lack of management's response to environmental changes. Following this analysis, a set of defects have been specified which could make a company sickness-prone, along with a set of mistakes that management might commit.

Three categories of defects have been identified: a) Management defects {autocratic style, passive Board, weak finance direclor); b) Accounting system defects (defective system of budgetary control, cash flow planning and costing); c) Defective response to changes (like technological changes and changes in market situation. etc.).

Mistakes likely to be committed are also divided into three categories, viz., a) Expanding operations without ensuring the availability of working capital; h) Pushing up debt-equity ratio too high; c) Undertaking too hig a project failure of which may also affect the established business.

It is suggested that points should be assigned to each category of defects and mistakes, with 43 per cent weightage for defects, 45 per cent for mistakes, and 12 per cent

weightage for other symptoms. If the weighted average score is then calculated for a company, it is contended that the score may be taken as an indicator or forewarning of possible failure well in advance. According to the analysts, management defects may continue as long as five years before other symptoms of failure are noticeable.

This approach is logically sound. because operational performance is basically a function of the quality of management. But it has practical difficulties. To evaluate the quality of management or identify management defects, one must have access to necessary information and have the opportunity of closely observing managers at work, which only an insider can have. Ordinary shareholders, creditors and investors cannot be expected to have such privilege. On the other hand, an impressionistic view can hardly be reliable. Thus, from the practical point of view, financial indicators are considered more useful,.

9.3.3 Use of Financial Ratios as Early Warning Signals

Based on statistical techniques applied to empirical data, some western analysts have identified a set of financial ratios which have predictive significance in relation to corporate failures. These are: i) Working capital to Total assets ratio, ii) Retained earnings to Total assets ratio, iii) Earnings before interest and taxes to Total assets ratio, iv) Market value of equity to Book value of total debt ratio, and v) Sales to Total assets ratio.

In the Indian context, empirical tests have shown that the following two profitability ratios have the best forewarning significance: 1) Earnings before depreciation, interest and taxes to Sales ratio; and 2) Operating cash ilows to Sales ratio. Two other ratios have been found to he the second best. These are: i) Ratio of earnings before depreciation, interest and taxes to Total assets plus accumulated depreciation; and ii) Operating cash flows to Total assets plus accumulated depreciation ratio. Besides, Net Worth to Total Debt ratio and All outside liabilities to Tangible assets ratio (known as 'solvency ratios') have also been found to he fairly good as early warning signals.

For small scale industrial units. the following five ratios are said to be reliable indicators of incipient sickness: i) Current assets to Current liabilities ratio, ii) Stock-in-trade to Cost of goods sold ratio, iii) Current Assets to Net Sales ratio, iv) Ratio of Net Profit before taxes to Total capital employed, and v) Net worth to Total outside liabilities ratio.

Check Your Progress **· A**

1, Which of the following statements are True and which are False ?

i) It is hetter to identify forewarnings of sickness in an industrial unit rather than recognising actual sickness.

ii) If the incidence of industrial sickness is high, the symptoms will be identical for all the units,

iii) ,All financial indicators are not suited for detecting incipient sickness.

iv) Declining share prices on the stock exchange is the first indication that a company is sick,

v) Prediction of sickness is only possible by evaluating the quality of management of a company.

2. Fill in the blanks:

i) There is a................ between incipient sickness and actual sickness of an industrial unit.

ii) Early warning signals are useful for ....sick units.

iii) Financial institutions consider an unit sick when accumulated losses have exceeded 50% of ....

iv) ....ratios have been found to be the most significant predictors of sickness. ,

v) From the practical point of view................indicators are considered more useful for predicting sickness.

vi) Three types of management defects which have been found to cause corporate failures are:................, and................, ...

9.4 CAUSES OF INDUSTRIAL SICKNESS

It is generally believed, and rightly so, that industrial sickness is caused by, not one, but multiple factors. One may logically argue that certain basic causes give rise to a chain of causation over time leading to more proximate causes and then the terminal causes. Naturally, the initial, root causes may he said to have vital significance. Prevention of sickness can he possible and effectiveness of remedies assured if the initial causes are clearly known.

There may be external factors as well as internal factors causing industrial Sickness. 'The external or exogenous factors may adversely affect particular units more seriously, although all units helonging to an industrial category are exposed to these factors. They are : intensity of competition, unfavourable market situation. recessionary trend, changes in government policy scarcity of raw materials, rising cost ot' production, rtc. Among internal (endogenous) causes of sickness, there may he factors relating to general management deficiencies, or to one or more functional areas of management like production, marketing, finance, etc.

Distinguishing between external and internal causes is not considered necessary, for it does not serve the purpose of causal analysis, namely, that of providing clues to remedial action. More than that, it may also prompt management to avoid responsibility on the ground that external factors are beyond their control. **As** one analyst has put it, "To assume that the so-called external causes are always heyond the control of management is to ignore the responsibility of management to anticipate threats or changes in the external environment and to be prepared for the usual vicissitudes of business lilt." To give an analogy in this context, "The collapse of a company is in some way similar to the sinking of a ship. If a ship is in good condition and the captain is competent, it is almost impossible for it to be sunk by a wave or a succession of waves. Even if there is a storm, the competent captain will have heard the weather forecast and taken whatever measures are needed. Only a freak storm for which quite inadequate notice has been given will sink the ship."

Nature of Causes - an Overview

Analytically, diagnosis of industrial sickness may he done keeping in view the stages of decline and ,failure. Thus, there niay he factors or flaws leading to sickness from the very inception of an unit, or flaws which are traceable to **managerial ineffectiveness,** or **exogenous — (industry-wide) factors** causing sickness.

Sometimes, industrial projects or units are afflicted hy factors from the very inception. which inevitably give rise to problems and lead to sickness. Such units may he said to have been born sick. Thus, sickness in these cases is traceable to one or more of the flaws mentioned below:

a) Wrong project selection and faulty project planning are often potent causes of industrial sickness. It may be because of promoters' lack of experience or over-optimism.

b) Faulty financial planning may he another factor which may cause problems at the operational stage. Undercapitalization along with overestimation of cash flows and funds flows, inadequate provision for contingencies, heavy investment in housing for employees, and such factors may create liquidity problem and prevent normal functioning.

c) In the case of large, projects, construction work often gets delayed and cause time and cost over-runs. This may not only involve increased cost of construction, but also lead to delay in commissioning the project and a rise in cost of production leading to shortage of capital and liquidity problem.

d) Sometimes problems may arise due to faulty location of the unit in a region with poor infrastructural facilities like power supply, water supply, transport and communication.

e) If the choice of technology is not appropriate, it may lead to inefficient production and higher cost of output. With such a competitive disadvantage, the unit is sure to run into losses. Also. the unit may not he ahle to take otf if the technology becomes obsolete during the implementation of the project.

f) A firm may he destined to face problems if there is over-estimation of the potential demand for its product, or there is wrong assessment of the intensity of prevailing competition in the product market, or likely changes in competitiveness or in consumer tastes and preferences have not been anticipated.

Managerial ineffectiveness may cause sickness over a period of time even when industrial units are well planned and well established. Underlying ineffective management may he such factors as a) Lack of professional competence of executives; b) Absence of cohesion and integrity of managers leading to poor overall management; c) Lack of ability to monitor changes in the environment and tack of alertness to the needs for modernisation of machinery, product innovation, variation of product-mix, etc. d) Lack of necessary skill and competence for strategic decision-making which lead to diversification or expansion of business without due regard to the risks involved and resource availability; e) Incapability of dealing with labour-management conflicts which may undermine productive efficiency; f) Managerial inefficiency in vital functional areas like production, marketing and finance.

As regards **exogenous factors** which may affect all units in an industry, managerial foresight may, to a certain extent, enable particular firms to overcome the problems. For instance, industrial recession which occurs periodically, may not prove to be equally damaging to all firms. With competent management, some firms may only suffer temporary set-hack, while some others may he wiped out. Even then, certain eventualities may he more difficult to foresee and hence are beyond the control of management. Thus problems may he posed by such external factors as: a) Credit squeeze due to change in monetary policy of the government; b) Shortage of essential raw materials caused by disruption in the major sources of supply, import restriction, or failure of crops due to natural calamities; c) Disruption in the supply of power, coal. fuel oil, etc. in the economy; d) Bottlenecks in transport and other facilities caused by external forces.

Check Your Progress B

1. Fill in the Blanks:

   i) The major cause of industrial sickness has been empirically round to b he.........................

   ii) Among the causes leading to industrial sickness, one of the.....................factors is the scarcity of vital inputs.

   iii) To assume that external causes of sickness are Beyond the control of management is to ignore the ....of management.

   iv) Faulty project planning may he due to promoters'..............................or ....

   v) Delay at the constructional stage of a project causes................ and...................... over-runs.

   vi) A firm is destined to face problems if there is.......................of potential demand.

2. Which of the following statements are True and which are False?

   i) Identifying root causes of sickness is not enough lo prevent sickness or find effective remedies.

   ii) A rise in cost of production is always due to faulty financial planning.

   iii) Ineffective management may he reflected in the lack of alertness to environmental changes.

   iv) A firm will suffer from a competitive disadvantage if the choice of technology is not appropriate.

   v) If an industrial unit is well planned and well established it can never be sick.

9.5 GOVERNMENT POLICY

The thrust of Government policy to meet the problem of sickness has been aimed at revival, reconstruction and rehabilitation of sick units. Different measures have been

adopted in this context, and a policy framework may be said to have emerged in the process in the eighties. Based on the measures adopted by Government from time to time, three interrelated approaches are discernible in the evolution of official policy:

1. Takeover of management and nationalisation;
2. Recourse to institutional agencies;
3. Policy guidelines and framework for administrative ministries.

Let us examine these approaches separately although they are interrelated.

9.5.1 Takeover of Management and Nationalisation

In view of the growing incidence of sickness in textile mills during the sixties, the Central Government decided to take over the management and control of the sick mills under the provisions of the Industries (Development and Regulation) Act, 1951. The National Textile Corporation Ltd. (NTC) was incorporated in April 1968 for managing the affairs of the sick mills taken over by the government. The Corporation set up nine subsidiary corporations in different states for effective management of the mills with a decentralised organisation. Most of the sick mills required modernisation and partial machanisation, which has been the major responsihility of NTC and its subsidiaries.

A comprehensive textile policy was formulated by the Government in 1985 for restructuring the textile mills. The policy required that potentially viable units should be identified based on a detailed and objective study of the causes leading to sickness. For such units, a nodal agency was to be designated to evolv" and manage suitable rehabilitation packages as well as work out financial packages for the purpose. In accordance with the policy, the Government designated Industrial Development Bank of India (IDBI) as the nodal agency, and set up a Textile Modernisation Fund in August 1086. The fund was intended to provide assistance to healthy units for modernisation as well as to the potentially viable sick units. For similar purposes, a Jute Modernisation Fund was set up by Government in Novemher 1986. The Industrial Finance Corporation of India (IFCI) was designated as the nodal agency 'to administer the Fund.

9.5.2 Recourse to Institutional Agencies

By the end of sixties, industrial sickness had assumed serious proportions in several other sectors besides textile and jute. For the revival and rehabilitation of sick units, the Government decided' to set up a specialised institution. Accordingly, the Industrial Reconstruction Corporation of India (IRCI) was set up in April 1971. The IRCI was empowered to undertake the following functions: a) to provide financial assistance to sick industrial units, b) to provide managerial and technical assistance to such units, c) to secure the assistance of other financial institutions and government agencies for revival and rehahilitation of sick units, d) to provide merchant banking services for amalgamation, merger, etc. and e) to provide consultancy services to banks on matters relating to sick industrial units.

During the next decade, till March 1984, the IRCI sanctioned financial assistance to 242 sick units amounting to Rs. 266 crore. It also developed consultancy services, merchant banking and equipment leasing, incidental and allied to its main task. Besides it provided credit facilities to the slate-level financial institutions towarrls the rehabilitation of small-scale units. However, hy 'mid-eighties, it was evident that the financial and manpower resources of the IRCI were inadequate to cope with the increasing magnitude of the problem of industrial sickness. The government, therefore, decided to reconstitute the IRCI. In March 1985 the IRCI was converted into a statutory corporation, titled Industrial Reconstruction Bank of India (IRBI).

The IRBI is constituted to function the principal credit and reconstruction agency for the revival of sick industrial units and to coordinate the work of other institutions engaged in the same task. Its authorised and paid up capital are Rs. 200 crore and Rs.50 crore respectively. Moreover, it can obtain interest free loan from the Government of India, and raise foreign loans with Central Government's guarantee. The IRBI has powers to take over the management of sick units assisted hy it, lease out or sell such units as running concerns, or prepare schemes for reconstruction. Moreover. it has powers to permit large multinational houses to participate in reconstruction plans for sick units.

Around the same time that the IRBI was constituted, the Board for Industrial and Financial Reconstruction (BIFR) was established by Government as provided for in the Sick Industrial Companies (Special Provisions) Act, 1985. This was an initiative taken for a coordinated approach to deal with sick industrial companies. The role of BIFR will be discussed in the next section.

With a view to supplementing the tasks of specialised institutions, the Government also introduced several schemes for the revival and rehabilitation of sick units:

i) **Soft loan scheme:** The scheme was introduced in November 1976 for cotton textiles, jute, cement, sugar and specified engineering industries, to extend financial assistance on concessional terms to the weaker units. The scheme provides for sanction of loans at concessional rate of interest and concession with respect to promoters' contribution, debt-equity ratio initial moratorium, period of repayment, and exemption from the convertibility clause. The overall responsibility of operating the scheme was entrusted to the IDBI with participation of ICICI and IFCI. Weaker units in the specified industries can obtain loans under the scheme for modernisation, replacement and renovation of old plant and equipment, which were in use for at least 10 years.

ii) **Merger scheme:** Introduced in 1977, the objective of the scheme was to encourage the merger of sick industrial units with healthy units. Towards that end, the scheme provided for an incentive to healthy units by permitting them to carry forward and set off the accumulated losses and unabsorbed depreciation of the sick units against their own tax liability after merger.

iii) **Margin money scheme:** The scheme provides for grant of margin money to sick units in the small-scale sector on soft terms so as to enable such units to secure funds from banks and financial institutions to implement their revival schemes. Introduced originally in January 1982, the scheme was liberalised in June 1987 to supplement the efforts of State Governments. Under the scheme, the State Governments are required to make a matching contribution on 50:50 basis in providing assistance to small-scale sick units in their rehabilitation. The maximum permissible assistance has also been increased from Rs. 20,000 to Rs. 50,000 per unit.

9.5.3 Policy Guidelines and Framework

Having examined the Government policies to meet the problem of industrial sickness, we should now take note of the policy guidelines issued in that context.

As the problem of industrial sickness became increasingly more serious during the 70s, the Government announced in 1978 that the responsibility of reviving sick units, instead of being borne by any one agency, should be shared by the Central and State governments, financial institutions, the Reserve Bank of India as well as the managements concerned. The Government also decided that the following factors would he kept in view while considering whether it would be proper for government to take over the management of any sick unit: a) the amount of additional capital to he invested in relation to the number of employees; b) the amount to he invested for rehabilitation compared to the cost of putting up a new plant of the same capacity; c) what is the probability of the unit becoming commercially viable within a reasonable period in the light of likely contributions to he made by the state government and financial institutions for discharging past liabilities, and by labour towards viable operation; d) the extent of co-operation of the participants in the scheme of revival.

In October 1981, guidelines were issued by the Government for the guidance of administrative ministries of the Central and State governments and financial institutions in respect of measures to deal with the problem of industrial sickness. The policy framework reflected in the guidelines as modified in February 1982 comprise the following elements:

1. For the prevention and remedial action in relation to sickness of units, the administrative ministries in the government will have specific responsibility for the industrial sectors within their respective charge. The ministries will have a central role in monitoring sickness of sick units. For this purpose standing committees may he appointed. if necessary, for industrial sectors where the incidence of sickness is widespread.
2. To ensure that timely corrective action may be taken to prevent incipient sickness, the financial institutions will have to strengthen the monitoring system. Where financial

institutions are confident of restoring a sick unit to healthy by assumption of management responsibility, they should consider such a step, particularly if the incidence of sickness is found to be high.

3. Outstanding dues of banks and financial institutions should be dealt with in accordance with normal banking rules and procedure where the sickness of an unit cannot he prevented or its revival cannot be ensured. The matter should however be reported to the government before steps are taken for recovery of dues so that government may consider any other alternative to revive the unit, or whether it may be nationalised.

4. In the event of government deciding to nationalise any industrial unit, its management niay He taken over for a period of six months, so that various alternatives like restructuring, merger with a healthy unit, etc, may be considered and, where necessary, steps may be taken for nationalisation.

Check Your Progress C

1. Which of the following statements are True and which are False?

   i) The National Textile Corporation was established only 'to manage sick textile mills till their nationalisation.

   ii) The IRBI is constituted to function as the principal credit and reconstruction agency for the revival of sick units.

   iii) The IRCI could not adequately deal with the problem ol' industrial sickness because it had limited powers.

   iv) Both sick and weaker units in all industries can avail of financial assistance under the soft loan schenie.

   v) The margin money scheme covers only sick units in the small-scale sector.

   vi) On the question of recovery of outstanding dues from sick units, Government policy is that it should be dealt with in all cases in accordance with normal banking rules,

   vii) The administrative ministries at the Centre and in the States have the responsibility of monitoring sickness in industries within their respective charge,

2. Fill in the blanks:

   i) The IRBI can obtain................ loans from Government and raise............... loans with Government guarantee,

   ii) The Textile Modernisation Fund was intended to provide assistance to................ units as well as .... units.

   iii) The merger scheme provides for an incentive to..............units to encourage merger with .... units.

   iv) For timely action to prevent ....sickness, financial institutions should strengthen the .... system.

   v) Weaker units can obtain loans under the soft loan scheme for replacement of................ plant which were is use for at least ....

9.6 SICK INDUSTRIAL COMPANIES (SPECIAL PROVISIONS) ACT, 1985

The necessity of a separate legislation to deal with the sickness of industrial companies mainly arose out of the serious implications ol' its growing incidence and the inadequacy of measures so far taken to cope with, the problem. Wide spread sickness of industrial undertakings not only meant enormous loss of production, threat of unemployment, and loss of revenue to the exchequer, but it also involved huge inevitable funds of banks and financial institutions being locked up in the sick units. This was of serious concern to the Government as well as the society at large. Revival and rehabilitation of potentially viable sick companies were required with minimum loss of time to ensure the optimum use of

production facilities and funds invested. At the same Lime, non-viahle units were required to be liquidated so as to recover as much of their debts as possible and salvage whatever productive assets were left.

A committee was appointed hy the government under the chairmanship of T.R.Tiwari to make an in-depth study of the problem of sickness. The Committee, which submitted its report in 1984, recommended the enactment of a special legislalion mainly on two grounds, viz., a) the existing institutional framework for dealing with the problem of sickness was inadequate as well as lime-consuming; and b) multiplicity of laws and agencies made it difficult for a coordinated approach to be adopted. The Sick Industrial Companies (Special Provisions) Act (SICA) was thus put on the legislative anvil in 1985. It was amended in December 1991 and again in December 1993.

SICA is a special legislation which has been enacted with a view to: a) securing timely detection of sick and potentially sick industrial companies, and b) ensuring speedy determination and expeditious enforcement of remedial and other measures with respect to such companies. The Act applies to all industries specified in the first schedule to the Industries (Development and Regulation) Act, 1951; it does not apply to small-scale and ancillary industrial units and industries relating to ship and other vessels drawn by power.

The Act provided for the constitution of a Board for Industrial and Financial Reconstruction (BIFR) by the Central Government. In the next section we'will discuss the role and functions of the BIFR. Under SICA, it is mandatory for the Board of Directors of a sick company to make a reference to the BIFR within 60 days from the date of finalisation of the audited accounts of the company. Sickness of a company may also be referred to the BIFR hy the Central Government, Reserve Hank of India, a State government, any public financial institution, state level institution or a scheduled bank.

On a reference being made to the Board, it may conduct an enquiry lo determine whether the company is sick. Alternatively, the Board may require any operating agency to enquire into and make a report on the matter. On completion of enquiry, if the company is found sick hut it is feasible for the company to make its 'net worth' exceed the accumulated losses within a reasonable Lime, the Board may require the company to do so within a specified time, In other situations, the Board may direct any operating agency to prepare a scheme in relation to the sick company ordinarily within a period of 90 days. The scheme may provide for one or more of the following measures: a) financial reconstruction of the sick company; b) proper management hy change in, or take over of management of the company; c) amalgamation of the sick company with any other company; d) sale or lease of the whole or a part of the undertaking; e) rationalisation of managerial personnel, supervisory staff, and workmen; and f) other appropriate measures.

On the basis of the order of the BIFR. implementation of the scheme is entrusted lo the operating agency. For this purpose, the agency may he required to prepare: i) a complete inventory of a) all assets and liabilities of the company, and h) all books of accounts, registers, documents of title or ownership of property. etc. ii) a list of shareholders, iii) a list of creditors showing separately the secured and unsecured creditors, iv) a valuation report in respect of the shares and the assets in order to arrive at a reserve price for the sale of the undertaking, or for fixation of the lease rent, or share exchange ratio in the event of amalgamation, v) an estimate or reserve price, lease rent or share exchange ratio, and vi) pro forma accounts where up-to-date audited accounts are not available.

The Board has been empowered to monitor periodically the implementation of the sanctioned scheme. Provision has also been made in SICA as regards financial assistance to he secured for the rehabilitation of a sick industrial company. A scheme may provide for financial assistance to the sick company by way of loans, advances, guarantees, concessions, etc. from the central government, slate government, hank, financial institutions or any authority. Such a scheme is required lo he circulated to the concerned persons for their consent. Once consent has been given hy every person, the scheme becomes binding on all concerned. Where consent has not been given by any person, the BIFR may adopt such other measures as may be considered appropriate including winding up of the company.

In general, winding up of a sick industrial company may be considered hy the Board where, after taking into account all relevant facts and circumstances and having heard the parties concerned, if it is of opinion that a) the company is not likely to be viable in

future, and h) it is just and equitable that the company should he wound up. The Board may then record its opinion and forward it to the concerned High Court. While passing the order for winding up, the High Court may appoint an officer of the operating agency as the liquidator of the company, provided it is so agreed.

As regards potentially sick industrial companies. it has been laid down in SICA that such a company must report to the BIFR the fact that its accumulated losses have resulted in the erosion of 50% or more of its peak net worth during the preceding four years. This report should be made within 60 days from the date of finalisation of the duly audited accounts of the company. It is also required that the company must hold a general meeting of the shareholders for consideration of such erosion. A report on the erosion and the causes thereof is to be forwarded to every member hy Board of Directors at least 21 days before the general meeting.

Potential sickness of an industrial company may also be reported to the BIFR by the central government, a state government. Reserve Bank of India. any financial institution, hank, or state level institution. The BIFR may then call for such information also from the concerned company.

If in the opinion of the BIFR, a potentially sick company is not likely to he viable within a reasonable time in future, it may issue orders for an operating agency to enquire into and report on the matter. Having,considered the report of the agency, the BIFR is to publish a notice in the daily newspapers for suggestions and objections, if any, as to why the coinpany should not wound. After considering the 'views of all parties, the BIFR may forward its opinion to the High Court for winding up of the company as if it were a sick industrial company.

Any person aggrieved by an order of the BIFR can make an appeal to the Appellate Authority for Industrial and Financial Reconstruction (AAIFR) within 45 days from the date of the order issued to him. The Appellate Authority after hearing the appellant and making necessary enquiry, may confirm, modify or set aside the order appealed against or remit the order for fresh consideration of the BIFR. I-Iowcvcr, orders of the BIFR or AAIFR are not appealable in Civil Courts.

9.7 ROLE OF BOARD FOR INDUSTRIAL AND FINANCIAIL,RECONSTRUCTION (BIFR)

For a coordinated approach to deal with sick ~~and potentially sick~~ industrial companies, the Board for Industrial and Financial Reconstruction (BIFR) was established under the provisions of the Sick Industrial Companies (Special Provisions) Act (SEA), 1985. A 'sick industrial company' has been defined in the Act as a company which has been in existence for at least five years, and which has accumulated losses in a financial year equal to or more than its net worth. The Act has made it obligatory for the Board of directors of a sick industrial company to report sickness of the company to the BIFR. which is empowered to institute necessary enquiries to determine whether the company is sick or not. If. the company is sick, the BIFR may either give reasonable time to the company to make its net worth positive, or. it may initiate suitable measures for the purpose. These measures may include a) change of management, b) measures for revival I rehabilitation of the company, c) reconstruction of share capital, d) sale or leasing out of a part or the whole of an undertaking, or e) its amalgamation/merger with a healthy unit. Further, if the BIFR is satisfied that a person has been responsible for diversion of funds or for managing the affairs of a company in manner detrimental to the interest of the company, then the Board may direct banks and financial institutions not to extend any financial assistance for a period of ten years to such a person. or to a firm of which he is a partner, or to a company in which he is a director. This provision has been made in SICA presumably as a warning to unscrupulous management.

As provided under Section 4 of SICA, the central government constituted the BIFR with effect from 12, January 1987, and it started operations in May 1987. BFR is a quasi-judicial body, consisting of experts in various relevant Fields, The Board has appointed operating agencies, which' include the FCI, IDBI, IRBI, the State Bank of India and seven other public sector commercial hanks. Any of these agencies may he nominated hy the Board to make inquiries-and formulate revival/rehabilitation packages for companies

declared sick. It may he mentioned that small-scale and ancillary industrial undertakings, and industries relating to ship and other vessels drawn hy power are excluded from the purview of SICA.

In general, the BIFR is empowered to enquire into and determine the incidence of sickness in industrial companies and devise suitable remedial measures through appropriate schemes or other proposals and for proper implementation of the same. Where the scheme relates to preventive, remedial and other measures with respect to any sick industrial company, the scheme may provide for financial assistance hy way of loans, advances, guarantees, reliefs or concessions from official agencies. If after making enquiry and after consideration of all relevant facts, the Board is of opinion that it is just and equitable for the sick industrial company to wind up its operations, it may record and forward its opinion to the concerned High Court. The Board has also powers to appoint one or more special Directors for the sick company in case of mismanagement.

Since its inception in may 1987, upto the end of December 1996, the BIFR received 2,692 references under SICA, both in respect of private,sector and public sector undertakings. Out of 2692 references received (including 188 public sector undertakings), 1853 references were registered which included 145 public sector undertakings. Of the 1853 references registered, 406 cases were dismissed as not maintainable, revival schemes were sanctioned or approved in 404 cases, and 496 cases were recommended to the concerned High Courts for winding up. On successful completion of the respective rehabililation schemes sanctioned, 184 companies have been declared 'no longer sick'. In the case of public sector undertakings, out of 145 references registered, 28 were dismissed as non-maintainable, rehabilitation schemes were recommended for 36, and winding up suggested for 24, while 4 undertakings have been declared 'no longer sick' on successful competition of the respective schemes of rehabilitation.

Check Your Progress D

1. Fill in the Blanks:

   i) The BIFR may nominate any................ to formulate revival scheme for a sick industrial company.

   ii) A sick industrial company is one which has accumulated losses equal to more than its ....

   iii) Small-scale and .... units are excluded from the purview of SICA.

   iv) The BIFR can appoint .... for a sick company in case of mismanagement.

   v) When there is erosion of .... of the peak net worth as a result of accumulated losses, the company is a potentially sick company.

2. Which of the following statements are True and which are False?

   i) If a potentially sick company cannot become a viable unit in future, the BIFR may order its winding up.

   ii) The provisions of SICA apply to all industrial companies registered under the Indian Companies Act.

   iii) A scheme for revival of a sick industrial company may provide for a change in management only and not necessarily any other measure.

   iv) Sickness of an industrial company may he referred to BIFR by the central government or any state government.

   v) The main objective underlying SICA has been to prevent industrial sickness.

9.8 LET US SUM UP

To understand the nature of industrial sickness, it is found useful to distinguish between symptoms which are in the nature of forewarnings, that is signals of incipient sickness, and symptoms which indicate actual sickness. Generally two or more indicators are taken into account to identify sickness. Financial indicators are widely used for the purpose because operational flaws are clearly reflected in the financial results of a firm. Cash

losses incurred hy an industrial unit are emphasised in the definition of sick units adopted by the Reserve Bank. Erosion of net worth as a result of accumulated losses is the main criterion adopted in the definition of sickness under the Sick Industrial Companies (Special Provisions) Act. However, in view of the limitations of financial indicators of sickness, identifying management deficiencies and non-financial factors become necessary for detecting early warnings of sickness.

Analytically, diagnosis of industrial sickness may he done keeping in view the stages of decline and failure. There may he flaws leading to sickness from the very inception of an unit, or managerial ineffectiveness which may he evident over a period of time, or exogenous Factors which may affect all units in an industry and cause sickness to the weaker ones.

The evolution of Government policy in relation to industrial sickness based on the measures adopted from time to time is discernible in the following approaches: 1) Take over of management and nationalisation; 2) Recourse to institutional agencies; and 3) Policy guidelines and framework for administrative ministries.

Fur a co-ordinated approach to deal with the sick and potentially sick industrial companies, the BIFR was constituted under the provisions of the Sick Industrial Companies (Special Provisions) Act (SICA), 1985. This was necessary because i) the existing institutional framework for dealing with industrial sickness was both inadequate and time-consuming, and ii) multiplicity of laws and agencies made it difficult for a coordinated approach to he adopted.

The provisions in SICA led to the constitution of BIFR, delineation of its role and functions, mandatory reporting of sickness and potential sickness to the BIFR, enquiry into the causes of sickness by operating agencies designated, preparation of schemes for revival and rehabilitation of sick industrial companies, and implementation of the schemes.

9.9 KEY WORDS

Incipient sickness : Sickness'of an industrial unit identifiahle on the basis of forewarnings or early warning signals.

Margin money scheme : Scheme to grant margin money to sick units in the small-scale sector to enable them secure funds from banks and financial institutions.

Merger scheme : Scheme to encourage merger or amalgamation of sick industrial units and healthy units by way of incentives to the latter.

Soft loan scheme : Scheme to provide financial assistance to weaker units in specified industries. on concessional terms.

9.10 ANSWERS TO CHECK YOUR PROGRESS

A. 1. i) True ii) False iii) True iv) False v) False

2. i) difference ii) reviving iii) paid up capital and reserves iv) profitability v) financial vi) management defects, accounting system defects, defective response to changes.

B. 1. a) mismanagement, b) exogenous, c) responsibility, d) lack of experience, over-optimism, e) cost, time, f) over-estimation.

2. i) False ii) False iii) True iv) True v) False.

C. 1. i) False, ii) True, iii) False, iv) False, v) True, vi) False, vii) True

2. i) interest-free, foreign, ii) healthy, potentially viable sick, iii) healthy, sick, iv) incipient, monitoring, v) old, 10 years.

D. 1. i) operating agency, ii) net worth, iii) ancillary, iv) special directors, v) 50% or more

2. i) False, ii) False, iii) True, iv) True: v) False.

9.11 TERMINAL QUESTIONS

1. Discuss briefly the nature of industrial sickness with particular reference to incipient sickness and actual sickness.
2. Defining 'sickness' is a difficult task. Do you agree? Give reasons.
3. Enumerate six financial indicators of sickness of all industrial unit. What are the limitations of these indicators.?
4. Discuss the usefulness of a) financial ratios, and b) lion-financial factors as early warning signals of industrial sickness.
5. Some industrial units are said to be born sick. Discuss briefly the causes which may lead to the sickness of such units.
6. What are the deficiencies of management usually related with the sickness of industrial undertakings'! Discuss.
7. Discuss the role and functions of i) IRBI, aiid ii) BIFR
8. Describe the main features of Government policy in relation to industrial sickness.
9. Write explanatory notes on:
   i) Soft loan scheme
   ii) Margin money scheme
   iii) Potentially sick industrial company
   iv) Measures which may he included in a scheme for rehabilitation of a sick industrial company
10. Outline the main provisions of the Sick Industrial Companies (Special Provisions) Act in relation to detection of sick industrial companies aiid enforcement of remedial measures

Note: These questions will help you to understand the Unit better. Try to write answers for them, hut do not send your answers to the University. These are for your practice only,

UNIT 10 INDUSTRIAL RELATIONS

Structure

10.0 OBJECTIVES

After studying this unit you should be able to:

- present the industrial relations scenario in the country
- identify the causes of industrial disputes
- review the industrial relations machinery for prevention and settlement of disputes
- explain the concept of collective bargaining and
- examine the various schemes of workers' participation in management.

10.1 INTRODUCTION

The concept of "industrial relations" has a wider meaning. It consists of a set of relations that arise out of functional interdependence between workers and management and between industrial organisations and society. According to Dunlop(1958) there are three principal actors in industrial relations : the employees, the employers and the Government.

In this unit you will get to know the industrial relations scenario in India. You will also study in detail the causes of industrial disputes, prevention and settlement of disputes, the working of dispute resolution machinery such as collective bargaining and 'workers' participation in management (WPM), for maintaining industrial harmony in the country.

10.2 INDUSTRIAL RELATIONS SCENARIO

Industrial relations plays a crucial role in establishing and maintaining industrial peace in the country. A number of factors — social, economic and political — have influenced

industrial relations in our country.

After independence significant developments have taken place in the field of industrial relations. The Industrial Disputes Act, 1947 was enacted which provides for establishment of permanent machinery for the settlement of industrial disputes.

The Indian Labour Conference (LC), a tripartite body, was set up with the objective of establishing cooperation between the Government, the employers and the trade 'unions.

Several labour laws were enacted during 1947-56 to protect the labour from exploitation. During 1957-65 initiatives were taken to introduce valuntary arrangements for resolving the industrial relations problems. However, the labour legislation laid more emphasis on adjudication and settlement of disputes rather than the promotion of sound labour-management relations.

The amendments to existing labour laws in mid 1970s and early 1980s sought to further strengthen the interest of workers. The workers however, resorted to violence mainly because : the Government failed to maintain the price level which is a critical factor in maintaining industrial harmony. Another reason was that it could not provide an effective machinery for speedy resolution of industrial disputes. To correct the situation the Essential Services Maintenance Act (ESMA) was passed which empowers the Government to ban strikes.' The employers developed new strategies based on sub- contracting, automation and the like which reduced their dependence on trade unions.

Liberalisation and Industrial Relations Machinery

The on-going process of liberalisation makes it imperative that suitable changes are made in the industrial relations machinery. The demands of the process of liberalisation are : **one,** industrial units should gain competitive strength; and **two,** industrial units should consolidate their past gains,

Both of these aims further require that:

i) The industrial units should upgrade their technology; the new technology is generally capital-intensive and labour-displacing; and

ii) The industrial units should shed their burden of surplus labour.

But, any of these measures cannot be pursued, given i) the hostile attitude of the trade unions to any of these proposals, and ii) the statutory provisions as contained in the Industrial Disputes Act which make retrenchment or a closure nearly impossible.

For a successful restructuring of the economy, as visualised by the New Economic Policy of liberalisation there is no alternative hut to push through these reforms in the industrial relations system.

10.3 CAUSES OF INDUSTRIAL DISPUTES

There are a number of causes of industrial disputes. Let us take a brief account of these causes in the following paragraphs.

1. Wages and Allowances

The demand for higher wages is the major cause of industrial disputes. Data show that about one-third of the total disputes in the country arise due to this reason. Workers may feel that: a) the existing wages are insufficient to provide a reasonable standard of living; b) wages and allowances have not increased in proportion to the increase in the cost of living; and c) their wages and allowances are lower compared to that of the workers in other comparable industries. Thus the demand for higher wages often leads to trade union activities like strikes, gheraos, etc. resulting in prolonged industrial disputes.

2. Bonus

The second major cause of industrial disputes relates to the issue of payment of bonus to industrial .workers, Disputes over the rate of bonus, and time and mode of payment have been common.

3. Personnel Matters

Poor personnel administration may also cause industrial disputes. In the absence of effective personnel management grievances and unrest may result into a dispute. Retrenchment of labour due to automation is also likely to cause a dispute.

4. Working Conditions and Labour Welfare

The demand for improvement in service conditions relating to security of jobs, hours of work, interval, leisure, leave, etc. causes industrial disputes. They are also caused by demand for social security measures.

5. Psychological Factors

A worker's satisfaction with the job is not only based on wages, hours of work, and other conditions of employment, it is also based upon the extent to which he enjoys his work. Psychological factors like denial of opportunity for self-expression, personal achievement, and betterment may cause unrest among workers.

6. External Factors

Certain causes are not directly connected with the industrial establishment itself. For example, the workers may go on sympathetic strike in support of fellow-workers in other establishments. Political factor is another important external factor. The workers may go on strike to protest against certain legislative measures or government policies.

It may therefore be observed that industrial disputes arise mainly due to various economic reasons. In order to improve the industrial relations in the country the governmenl has undertaken a number of measures in this direction. The arrangements for prevention and settlement of disputes are discussed in detail in section 10.4 below.

Check Your Progress A

1 Name the three principal actors in industrial relations.

a) ....

b) ....

c) ....

2 State the reasons why the workers had to resort to violence.

....

....

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....

3. Identify the ways by which industrial units could gain coinpetitive strength in the present scenario.

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10.4 PREVENTION AND SETTLEMENT OF DISPUTES

In the previous section you have studied various causes of industrial disputes. Disputes. if not settled in time, take the form of strikes and lockouts resulting in loss of profits, wages, production and supply of goods. It is therefore necessary that industrial relations are cordial, so that industrial peace could he maintained in the country. The Government. being aware of the problem, has already taken various measures to cope with industrial disputes.

The various measures for the prevention and settlement of industrial disputes can be broadly categorized into: i) statutory measures, and ii) non-statutory measures. Statutory measures relate to the various types of machinery set up by Government under the Industrial Disputes Act, 1947. The industrial relations machinery as provided in the Act constitutes- a) Conciliation, b) Arbitration, and c) Adjudication. Non-statutory measures, such as the code of discipline, workers' participation in management and collective bargaining are supported by government and help in settlement of disputes. Let us examine the various measures in detail below.

10.4.1 Statutory Measures

a) Conciliation

Conciliation is a method which brings about a settlement in disputes through the intervention of a third party. The objective of this method is the speedy settlement of dispules. Conciliation may be either voluntary or compulsory. Under voluntary method of conciliation, the slate provides the conciliation machinery which the disputants use whenever they require it. Under compulsory conciliation, the state not only creates the conciliation service but also imposes an ohligation on the parties to submit their disputes to conciliation service.

The Industrial Disputes Act, 1947 provides for conciliation as a method for settlement of disputes. The appropriate Government can either appoint conciliation officers or constitute board of conciliation. Conciliation, under the provisions of this Act, is compulsory for public utility services while it is not so in private Ones.

The conciliation officer, appointed by the Government, tries to hring the two parties together, towards a settlement of their disputes. In this process, he listens to the case of both the parties and proposes a compromise or a solution to the problem. The solution may or may not be acceptable to the parties. Thus, it is essentially a process of trying to bring the two parties together, without imposing the conciliation officer's decision.

The conciliation officer has to mediate a case within 14 days and send his report to the Government. The Board of Conciliation has to finish its work within two months and submit the report to the Government.

In cases where a settlement is arrived at, they can record the settlement. In cases of failure of the conciliatory negotiations, they can only send a failure report to the appropriate government. The government then refers the dispute for adjudication.

In the field of industrial relations, conciliation has been most frequently used for settling disputes. No doubt, it has brought about a successful resolution of a large number of disputes. However, conciliation machinery was generally found inadequate because of the following reasons: i) considerable'delays involved in conciliation proceedings, ii) lack of training and competence on the part of conciliation officers, iii) political interference, and iv) inadequate staff of the conciliation machinery.

b) Arbitration

Arbitration is different from conciliation. Under this method, the decision is binding on the parties. The arbitrator gives his judgement on the basis of the evidence submitted to him by employers and the employees.

Arbitration is either voluntary or compulsory. Under voluntary arbitration, both the parties show willingness to go to an arbitrator and submit to his decision. In compulsory' arbitration, the parties are forced to arbitration by the Government. This is also called adjudication.

The Industrial Disputes Act, 1947 provides for voluntary arbitration. Under this method — i) the industrial dispute must exist or be apprehended; ii) the agreement must be in writing, iii) the reference to voluntary arbitration must he made before a dispute has been referred to a labour court, industrial tribunal or national tribunal; iv) the name of arbitrator/ arbitrators must be specified; and v) the arbitrator shall investigate the dispute and submit to the appropriate government the arbitration award signed by the arbitrator.

In order to encourage arbitration for solving industrial disputes the Government of India has set up National Arbitration Promotion Boards in all the states. However, this method has not been popular in India.

c) Adjudication

If a dispute is not settled by other methods such as conciliation and arbitration, the government may refer it for adjudication. Thus adjudication is the last resort for the settlement of an industrial dispute.

The Industrial Disputes Act, 1947 provides for the adjudication machinery by setting, up i) labour courts, ii) industrial tribunals, and iii) national tribunals.

i) **Labour Courts :** The Industrial Disputes Act empowers the appropriate government to constitute labour courts. Labour courts consist of one person only who is or has been a judge of a High Court. Labour Courts adjudicate in the following matters :

   i) the propriety or legality of an order passed by an employer under the standing orders;

   ii) discharge or dismissal of workmen;

   iii) withdrawal of any customary concession or privileges;

   iv) illegality or otherwise of a strike or a lockout; and

   v) all other matters not reserved for the industrial tribunals or national tribunals.

ii) **Industrial Tribunals :** This is also a one-man body. Industrial tribunals can adjudicate on matters related to

   i) wages, including the period and mode of payment

   N compensatory and other allowances

   iii) hours of work and rest intervals

   iv) leave with wages and holidays

   v) bonus, profit-sharing, provident fund and gratuity

   vi) rules of discipline

   vii) rationalisation

   viii) retrenchment and closure of establishment

   The ahove shows that industrial tribunals have wider jurisdiction than the labour courts.

iii) **National Tribunals :** Under the Industrial Disputes Act the Central Government is empowered to constitute a national tribunal, if a) the industrial dispute involves question of national importance; b) industrial establishment located in more than one state are likely to be affected by such a dispute.

   During the last few decades adjudication machinery has exercised considerable influence on several aspects of labour-management relations. But adjudication suffers from procedural defects. The adjudication machinery has failed to achieve industrial peace. It has even prevented the voluntary settlement of disputes' and growth of trade unions,

10.4.2 Nan-Statutory Measures

Code of Discipline

The Code of Discipline came into effect in June 1958. It requires employers and workers to utilise the existing machinery for settlement of their disputes. And they should neither resort to strikes or lockouts nor to unfair work, practices. The Code of Discipline also specifies the various steps for dealing with industrial relations problems. The Government has set up various agencies at the centre and state level to implement the Code of Discipline. At the centre it is the Central Industrial Relations Machinery,

The other two non-statutory measures namely workers' participation in management and collective bargaining are discussed in detail in the following sections,,

Check Your Progress B

1. List out the various statutory measures provided under the Industrial Disputes Act. 1947.

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2. State whether the following statements are True or False.

   i) Conciliation is not compulsory for public utility services.

   ii) Conciliation involves a third party intervention.

   iii) Arbitration is the most popular method in' India.

   iv) Adjudication is the last resort for the settlement of an industrial dispute.

   v) Labour Courts have a wider jurisdiction than Industrial Tribunals.

3. The conciliation machinery was found inadequate. Why?

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10.5 COLLECTIVE BARGAINING

10.5.1 The Concept.

Collective bargaining is defined as negotiation about working conditions and terms of employment between two groups — one group representing the employers and the other representing employees. The objective of collective bargaining is to come to an agreement and avoid confrontation. The process of collective bargaining is bipartite in nature. The employers and employees are the only parties involved in the bargaining process. There is no third party intervention.

10.5.2 Types of Collective Bargaining Agreements

The collective agreements between employers and workmen may be classified into three categories:

1. Agreements which are totally voluntary in nature for purposes of their implementation
2. Settlements negotiated and settled primarily by the parties but registered before a conciliator in settlement
3. Agreements which acquire legal status because of successful discussion between the parties, when the matters in dispute are pending before a tribunal, the agreements reached being recorded as consent awards.

Collective bargaining is generally conducted at three levels: i) plant level, ii) industry level, and iii) national level.

i) **Plant Level:** where negotiations are conducted between the management of the plant and union(s) of the plant.

ii) **Industry Level:** several units in the same industry together form an association which negotiates with the recognised industry union. The scope of these agreements is broader than the plant level settlements.

iii) **National Level:** the scope and terms of reference are much wider for national level agreements. The representatives of the trade union and the employer negotiate and

arrive at a settlement. Such national level agreements are not common in India.

10.5.3 Collective Bargaining Process

The process of collective bargaining starts with a charter of demands being presented to the management by the unions. The first step is establishing a relationship for on-going negotiations. A great deal of effort goes into the process of establishing a collective bargaining relationship. The second step in the bargaining process relate to the scope of bargaining, that is, the matters on which to bargain. The third step in the bargaining process is careful structuring which facilitates the parties to reach agreements.

The bargaining parties should be balanced in terms of number of representatives present. Both the parties should agree on the timing, location, and length of the bargaining sessions. At the bargaining table, the representatives must come equipped with the necessary information and data regarding the firm's economic status, the prevailing rates of pay and conditions of employment in comparable firms in the local areas. The management should take into consideration the financial liability involved, the past agreements, and the impact of present negotiations in future.

10.5.4 Pre-requisites for Collective Bargaining

The following are the pre-requisites for successful collective bargaining:

i) Collective bargaining requires a degree of maturity on the part of negotiating parties.

ii) The union participating in the collective bargaining process must be strong. At the same time, the management should recognize the union and bargain in good faith.

iii) Both the parties need to have flexibility in making adjustments to the demands made.

iv) They need to gather comparable data on wages and other welfare benefits in similar industries in the region.

v) The complexity of the collective bargaining agenda requires experience and skill on the part of the negotiators.

10.6 WORKERS' PARTICIPATION IN MANAGEMENT (WPM)

10.6.1 The Concept

The concept of workers' participation in management (WPM) is viewed as a mechanism where workers have a say in the decision-making process of an enterprise.. This is possible if the workers are treated as 'partners' in the management of the enterprise, i.e., the workers participate in management and share the responsibilities of it.

The scope and the extent of workers' participation depends on the objectives set to be achieved by the three actors of the industrial relations system — the employees, the employer, and the government. In India, the workers expect that WPM will lead to the achievement of security of employment, better wages, bonus, etc. The employers interest is to maximise profits through increased production. The Government expects WPM to bring about an increase in productivity and peaceful industrial relations.

10.6.2 Schemes of WPM in India

Three major schemes of WPM have been introduced in India. These schemes provide for the setting up of i) works committees, ii) joint management councils, iii) shop councils; and iv) joint councils.

i) Works Committees

The Industrial Disputes Act, 1947 provides for the setting up of a works committee with a view to i) promote measures for securing and preserving good relations between employers and workmen; and ii) sort out differences of opinion in respect of matters of common interest to employers and employees.

~ h Committee consists of equal number of.elected representatives of the employers and employees. The Works Committee's recommendations have no binding either on the employers or on employees. Their functioning, however, is not satisfactory due to a) lack of clarity in the scope and functions of the committees; b) conflict between the elected representatives of the works committees and c) lack of adequate support from trade unions operating in the enterprises.

ii) Joint Management Councils (JMCs)

The Industrial Policy Resolution, 1956 observed that, 'in a socialist democracy labour is a partner in the common tusk of development and should participate in it with enthusiasm. There should be joint consultation and workers and technicians should, wherever possible, be associated progressively in management'. The JMCs, consisting of representatives of workers and management, were introduced in 1958. The essential features of JMC scheme are : a) the council is entitled to he consulted on certain specified matters, b) in some other issues, the management is expected to share information with the council, and c) in a set of functions administrative responsibilities have to he given to the council. All such matters as wages, bonus and allowances which are subjects under collective bargaining were excluded from the scope of the JMCs.

The main **objectives** of the JMC scheme are as follows: i) to promote cordial relations between management and workers, ii) to huild understanding and trust between management and workers; iii) to improve the efficiency of the workers; iv) to provide welfare facilities to the workers; and v) to educate workers to be equipped to participate in these schemes.

The scope of the JMCs is wider than that of Works Committees. Another point of difference is that JMCs are supposed to have administrative responsibility for welfare measures, safety, vocational training, etc.

The progress of the JMC scheme has been slow due to several reasons. The National Commission on Labour observed that the scheme of JMCs did not meet with success. The JMCs had to face many difficulties in their working which relate to management, workers and trade unions. Some of the problems have been as follows: i) lack of faith and commitment to the scheme on the part of management, ii) lack of clarity in the objectives of the scheme, iii) the differences .that exist between management and workers, iv) the indifferent attitudes of both management and workers; v) non-implementation of decisions of the council or delay in their implementation, vi) inter union and intra-union rivalries.

iii) Shop Councils

A scheme for workers' participation in industry was announced by the Government in' October 1975. The scheme provides for shop councils at the shop level and joint councils at the enterprise level.

The main **features** of shop councils scheme are as follows:

a) the scheme is applicable to enterprises employing 500 or more workers,

b) each enterprise should constitute one or more shop councils for the whole unit;

c) each shop council consists of an equal number of representatives of employers and workers; the employers representatives are nominated by the management **and** the representatives of workers must belong to the shop or department concerned;

d) the number of shop councils is decided by the employees in consultation with the recognized union;

e) the number of members of each council may be determined by the employer in consultation with the recognized union;

f) the decisions of the'shop council will be taken on the basis of consensus and not by voting;

g) the decision of a shop council is to be implemented by the parties concerned within a period of one month;

h) . a shop council, once formed, will function for a period of two years;

i) the shop council should meet at least once a month;

j) the chairman of the shop council should be a nominee of the management and a vice-chairman should be elected from amongst workers.

The main functions of the shop councils are: to improve production, productivity and efficiency; to study problems of absenteeism, low productivity and recommend measures to reduce them; to assist in maintaining discipline in the shop; to look after safety measures and other physical working conditions, welfare and health conditions of the shop; and to ensure flow of two-way communication between management and workers, particularly on matters relating to production targets.

iv) Joint Councils

The tenure of a joint council is for two years. Its chairman will be the chief executive of the unit. The vice-chairman will be nominated by the workers' members of the council. The secretary will be appointed by the joint council who will be responsible for discharging its functions. The joint council will meet once in four months. The decisions of the joint council are taken by consensus. The decisions shall be implemented within one month.

The main functions of joint councils are: a) fix productivity norms; b) resolve matters which are unresolved by the shop councils; c) see that the production targets are achieved to make optimum use of raw materiels; and d) look after the general health and safety measures of the unit as a whole.

It may be observed that in India WPM has not achieved the objectives of cooperation between workers and management. A number of factors have contributed to this: the indifferent attitude of management towards the schemes; lack of follow up measures on the part of government for implementation of the schemes, lack of understanding on the part of trade unions and their attitude towards the scheme.

Certain pre-requisites such as efficient management, a strong trade union, educating the workers for effective participation will help the successful implementation of WPM schemes.

Check Your Progress C

1. Define collective bargaining.

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2. Mention any two pre-requisites for successful collective bargaining.

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3. What are the main objectives of JMC scheme?

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10.7 LET US SUM UP

Industrial relations plays a crucial role in establishing and maintaining industrial peace in the country. A number of factors — social, economic and political — have influenced industrial relations in our country.

After independence significant developments have taken place in the field of industrial relations. The Industrial Disputes Act, 1947 was enacted which provides for establishment of permanent machinery for the settlement of industrial disputes.

The various measures for the prevention and settlement of industrial disputes can be broadly categorised into: if statutory measures and, ii) non-statutory measures. Statutory measures relate to the various types of machinery set up by Government under the Industrial Disputes Act, 1947. The industrial relations machinery as provided in the Act constitutes- a) conciliation, b) arbitration, and c) adjudication, Non-statutory measures, such as the code of discipline, workers' participation in management and collective bargaining are supported by government and help in settlement of disputes.

Several labour laws were enacted to protect 'the labour from exploitation. The labour legislations however. laid more emphasis on settlement of disputes rather than the promotion of sound labour management relations.

10.8 KEY WORDS

Conciliation : a method which brings about settlement in disputes through the intervention of a third party.

Collective bargaining : negotiation about working conditions and terms of employment between two groups- one group representing the employers and the other representing employees.

Workers' participation in Management (WPM) : a mechanism where workers have a say in the decision-making process of an enterprise.

10.9 ANSWERS TO CHECK YOUR PROGRESS

A 1, a) employees

b) employers

c) government

B 2, i) False, ii) True, iii) False, iv) True, v) False

10.10 TERMINAL QUESTIONS

1. Define the concept of industrial relations. Briefly explain the industrial relations scenario in India since independence.
2. Write a note on the various causes of industrial disputes?
3. Examine the various measures for the prevention and settlement of industrial disputes.
4. Explain the concept of collective bargaining. What are the types of collective bargaining agreements and how it is conducted?
5. Discuss the schemes of workers' participation in management.

Note: These questions will help you to understand the Unit better. Try to write answers for them, but do not send your answers to the University. These are for your practice only.

UNIT 11 SMALL SCALE SECTOR

Structure

11.0 OBJECTIVES

After studying this unit you should be able to:

- define what is a small scalc industry (SSI)
- explain the significance and growth of small scale sector (SSS) in India
- state the problems faced by SSS
- present the institutional framework for SSIs.
- critically evaluate the Government policy towards SSIs

11. INTRODUCTION

The small scalc sector (SSS) plays a significant role in our economy. It has a high potential for generating employment, contribution to industrial production, aiid dispersal of units to rural and backward areas. It also helps in promoting entrepreneurship and earning foreign exchange. This is the reason why small scale sector has been accorded an important position in the successive industrial policy formulations and the five year plans.

In this unit you will study the significance and growth of small scale sector in the Indian economy, and various problems that these institutions are facing. You will also get acquainted with the programmes and policies for small scale industries and the existing institutional framework to facilitate their growth. However, this unit aims to concentrate mainly on small scale industry.

11.2 SIGNIFICANCE AND GROWTH OF SMALL SCALE SECTOR

11.2.1 Definition

A small scale industrial unit is defined in terms of initial investment in plant and

machinery, whether held in ownership terms or by lease or by hire purchase. The definition of has been periodically revised by raisin$ the ceiling of investment (Table 11.1).

Table 11.1: Small Scale Industry: Definitional Changes

Investment Criterion			Employment Criterion
Period	Small Scale	Ancillary	
Up to 1958	Fixed capital investment up to Rs. 0.5 million	Fixed capital investment up to Rs. 0.5 million	Employment up to 50 workers if using power or up to 100 workers if not using power
1960	Gross value of fixed assets upto Rs.0.5 million	Gross value of fixed assets upto Rs.1.0 million	Employment criterion dropped
1966	Investment only in plant and machinery up to Rs. 0.75 million	Investment only in plant and machinery up to Rs. 1.0 million	
1975	Rs. 1.0 million	Rs. 1.5 million	
1980	Rs. 2.0 million	Rs. 2.5 million	
1985	Rs. 3.5 million'	Rs. 4.5 million	
1990	Rs. 6.0 million	Rs. 7.5 million	
1997	Rs. 30.0 million	Rs. 30.0 million	

In 1966 the small scale units were defined as undertakings with a fixed capital investment of less than Rs.7.5 lakhs and ancillary units with a fixed capital investment of Rs.10 lakhs.

In 1975 the investment limit was raised to Rs. 10 lakhs for small scale units and Rs. 15 lakhs in case of ancillaries. In 1977 the concept of tiny unit was introduced; it was defined in terms of investment limit upto Rs. 1 lakh. Under the Industrial Policy Statement of 1980, this limit was further raised to Rs. 20 lakhs for small scale units, Rs. 25 lakhs for ancillary units and Rs. 2 lakhs for tiny units. In 1985 the investment limit was again raised to Rs. 35 lakhs for small scale units and Rs. 45 lakhs for, ancillary units.

According to the Industrial Policy Statement of 1990, the investment ceiling for small scale units has been raised from Rs. 35 lakhs to Rs. 60 lakhs and for ancillary units from Rs.45 lakhs to Rs. 75 lakhs. Investment ceiling with respect to tiny units has been increased from Rs. 2 lakhs to Rs. 5 lakhs.

In 1997 the investment limit has been further raised to Rs.3 crore for both small scale and ancillary units. The investment limit for tiny units has been enhanced to Rs. 25 lakh.

11.2.2 Significance

In the earlier section we studied that the small scale sector has a high potential for providing employment, dispersal of industries and promoting entrepreneurship. This sector plays a very important role in our industrial economy because of its low capital intensity and the capacity of earning foreign exchange for the country. Given below are some of the points which demonstrate the significance of small-scale industries.

Emphasizing the importance of small industries in the economic development the Industrial Policy Resolution of 1956 stated:

"They provide immediate large-scale employment, they offer a method of ensuring a more equitable distribution of the national income and they facilitate an effective mobilisation of resources of capital and skill which might otherwise remain unutilised. Some of the problems that unplanned urbanisation tends to create will be avoided by the establishment of small centres of industrial production all over the country."

The Industrial policy Resolution, therefore, places the following arguments in favour of small industries.

1. **The employment Argument:** It is based on the assumption that small enterprises ate labour intensive and thus create more employment per unit of capital employed. A

developing economy is characterized hy high incidence of unemployment and, therefore, small enterprises which help to enlarge the volume of employment with scarce capital should be encouraged.

2. **The Equality Argument:** It suggests that the income generated in a large number of small enterprises is dispersed more widely than income generated in a few large enterprises. Thus small scale industries will not only lead to equitable distribution hut reduce the concentration of economic power as well.

7 **The Latent Resources Argument:** This argument suggests that —

   i) small enterprises are capable of tapping latent and unutilised resources;

   ii) small enterprises encourage the growth of a class of small entrepreneurs which is more dynamic and efficient and

   iii) small enterprises are able to bring idle savings in productive use.

4. **The Decentralization Argument:** Large-scale industries are mostly concentrated in metropolitan cities. It is therefore necessary to prevent congestion in large cities. Smaller towns and remote villages should also benefit from modern industrialisation. This is possible by setting up small enterprises and promoting industrial growth in semi-urban and rural areas.

5. **Other Arguments**

   i) The rise of new industries like computers has made it possible for small units to access modern technology and new skills. This will enable the small units to improve the quality of their products and reduce the costs.

   ii) The small units are more innovative and productive due to inherent advantages that they have in terms of flexibility of decision making.

   iii) Small units are quick in studying the changes in tastes of consumers and in adjusting their production process according to the needs of consumers.

   iv) When a new line of production is started on a small scale the minimisation of risk is possible.

   v) Small units are the symbols of national identity. They are always locally owned and controlled and would strengthen the social systems and cultural traditions of national identity.

11.2.3 Growth

The small scale sector has witnessed a phenomenal growth in the post-independence period and today it has emerged as a prominent sector in our economy. Growth in the small scale sector can be measured in terms of the following criteria: i) Industrial units, ii) Production, iii) Employment, iv) Capital investment and v) Exports. The growth has been consistently significant not only in terms of units but in terms of employment and production as well (Table 11.2). The phenomenal growth in the sector is mainly due to the encouragement, support and guidance given by the Government.

Table 11.2: Growth of Small Scale Industry (1980-81 to 1992-93)

Year	Number of Units (Lakh)	Employment (Lakh No.)	Production (Rs. Crore at current prices)
1980-81	8.74	71.0	28,060
1981-82	9.62	75.0	32,600
1982-83	10.59	79.0	35,000
1983-84	11.55	84.2	41,620
1984-85	12.40	90.0	50,520
1985-86	13.53	96.0	61,228
1986-87	14.62	101.4	72,250
1987-88	15.83	107.0	87,300
1988-89	17.12	113.0	106,400
1989-90	18.23	119.6	132,320
1990-91	19.48	125.3	155,340
1991-92	20.80	120.8	178.699
1992-93	22.35	134.0	209,300

Data show that the number of small scale units grew from about 9 lakhs in 1980-81 to nearly 29 lakhs in 1996-97. During the same period, employment generaled by these units went up from 71 lakh to 160 lakhs. The value of production increased from Rs.28,060 crore to Rs. 4,12,636 crore during the same period. The value of exports by small scale units increased from Rs. 1,641 crore to Rs. 39,249 crore during this period. It is important lo note here that according to some estimates, exports from the small scale sector account for about 35 per cent of the total value of exports from India.

Some of the industries in the small scale sector which contribute significantly to exports are ready-made garments. leather products, handicrafts, gems and jewellary, hosiery and marine products. and of course the computer software, etc.

Check Your Progress A

1. What is the definition of a small scale industrial unit?

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2. Give the equality argument in favour of the small industries.

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3. State the different criteria for measuring the growth in the small scale sector.

   i) .... ii) ....

   iii) .... iv) ....

4. Fill in the blanks:

   i) The small scale sector helps in promoting .... and earning ....

   ii) In 1977, the concept of...................................... unit was introduced.

   iii) Small enterprises are able to bring idle savings in .... use,

   iv) When a new line of production is started on a small scale the — of risk is possible.

   v) Small units are the symbol of ....

11.3 PROBLEMS OF SMALL SCALE SECTOR

In the previous section we have discussed the significance and growth of small scale sector. The contribution of small scale industry to Indian economy in terms of employment generation, industrial production, and exports is remarkable. However, the organisational pattern of these industries places them at a disadvantage which gives rise to various problems. Let us study in detail the major problems being faced by the small scale industry.

1 **Availability of Raw Materials:** Scarcity of raw materials is one of the major problems faced by small scale industry. This means a waste of productive capacity for the economy and a loss to the unit. Despite the various measures taken by government for supply of raw materials to the small scale sector, this sector does not get a proportionate share in raw material allocation.

   Moreover many small scale industries use imported raw materials. Whenever there is a difficulty in obtaining this raw material either on account of foreign exchange shortage or some other reason, these industries have to suffer a setback.

2. **problem of Finance:** Inadequate arrangement for finance and credit is the main obstacle in the development of small scale units. Considering the vital role of small industries in our industrial economy, the total amount of loans granted to small industries forms a very small part of the total loans to Indian industries. In the recent years there has been some improvement with formalisation of financial assistance to these industries. However, most artisans and craftsmen particularly those helonging to the poorer sections of the society and working in small towns and villages are still unable to obtain their credit requirements.

3. **Problem of'Marketing:** Marketing constraint is another major problem being faced by small scale industries. In the absence of any marketing organisation most of these industries are forced to restrict their sales to the local market only. Since they cannot draw the customers from distant markets they are compelled to restrict their scale of operation. Because of lack of demand they have to face shortage of working capital and financial resources which often forces them to sell their products at lower prices.

4. **Shortage of Power:** The small producers are the worst affected by the problem of shortage of power. Due to non-availability of cheap power the small scale industries are not able to fully utilise their capacity. These industries have to manage wilhin the available means as they can not afford to have their own power units which involve heavy costs.

5. **Problem of Technical Assistance:** Low level of technology and shortage of trained and experienced supervisory personnel have hampered the development of small scale industries. Having no access to latest developments in the field of knowledge and skills, productivity of these industries continues to he low. Another widespread problem is sickness among small units which you have already studied in unit 9 of this Block.

11.4 INSTITUTIONAL FRAMEWORK FOR SMALL SCALE INDUSTRY

Over a period the government has evolved an exteusive institutional network for the promotion and growth of small-scale industry. These institutions are spread at different levels-national Icvel, stale level and district level — to look after different aspects of the development programmes.

11.4.1 National Level Institutions

Small Industries Development Organisation (SIDO)

SIDO, headed hy a Development Commissioner, is under the Ministry of Industry. This is an apex body which acts as a policy formulating, coordinating and monitoring agency for the development of small scale industries in the country. It seeks to provide technical, economic and management consultancy services to small scale units. It also provides training , common facility services, common processing and testing facilities, tooling facilities, marketing assistance, etc. to these units. SIDO provides these services through a network of institutions. It has 28 Small Industries Services Institutes (SISIs), 30 branch institutes, 37 extension centres, 19 field testing centres, 4 regional testing centres and 2 footwear training centres.

SISIs and their branches and extension centres provide the following services:

i) provide technical and managerial consultancy to existing and potential small entrepreneurs.

ii) organize training programmes on technical and managerial issues.

iii) make techno-economic surveys in select areas and industries to identify new industrial opportunities.

iv) conduct entrepreneurship developmenl programmes to motivate new entrepreneurs.

v) provide common facility services and vocational training.

vi) prepare reports for modernisation of select units in select industries.

SIDO conducts entrepreneurship development programmes through the SISIs and their branches. The programmes initially started for graduate engineers, have been later extended to women, educated unemployed, artisans, technicians, physically handicapped and weaker sections of the community. SIDO provides export marketing information, . . . export consultancy and organises training courses and seminars for promoting exports. SIDO publishes a monthly journal — Laghu Udyog Samachar — both in Hindi and English to disseminate information for the benefit of existing and prospective entrepreneurs and concerned agencies.

National **Small Industries Corporation (NSIC)**

NSIC supplies machinery to small enterprises on hire purchase basis. Its other functions include promotion of schemes for supplying raw materials and components to SSI and provides marketing and export assistance.

National Institute of Small Industry Extension Training (NISIET)

It conducts training programmes in the areas of development, promotion arid management of small. rural and artisan industries. preparation of feasibility reports, project reports, training methods. etc The Institute's services are utilized for consultancy hy central and State Government departments in their programmes for small industry development.

National Institute for Entrepreneurship and Small Business Development (NIESBUD)

This is an apex hotly for coordinating entrepreneurial development programmes organised hy various entrepreneurship development institutes in the county. The institute organises training programmes for motivators, trainers and entrepreneurs. It also coordinates training activities ot various institutions and agencies. It prepares model training syllabus for various organisations engaged in training activities.

Small Industries Development **Rank of India** (SIDBI)

It is the apex financial institution engaged in the development of small industry. SIDBI provides both direct and indirect financial assistance to small industrial units. It renders direct assistance for specialized marketing agencies, industrial estates, acquisition of machinery, equity capital through soft loan schemes etc. It provides direct assistance through commercial banks.

11.4.2 State Level Infrastructure

At the stale level. Directorate of Industries is the apex hody for coordinating and implementing various programmes for small industry development. The Small Industries Development Corporations (SIDCs) play a major role through the provision of industrial services. The State Financial Corporations (SFCs) meet the term loan requirements of small Industries. SFCs have branches in most of the districts in each state.

Most of the states have set up their own entrepreneurship development institutes. Recently some of the states have initiated small Industries Marketing Corporations.

11.4.3 District Level Centres

District Industries Centres Programme was launched in 1978 to provide different services and support to village and small entrepreneurs under one roof. Today, there are 422 District Industries Centres (DICs) to cover 431 districts out of the total of **436** districts in the country. DICs are jointly sponsored hy the Central and State Governments.

Check Your Progress B

1. List out the problems of small scale sector.

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2. What kind of services do the SISIs provide'!

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3. What are the activities of SIDBI?

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11.5 GOVERNMENT POLICY TOWARDS SMALL SCALE INDUSTRY

11.5.1 Industrial Policy for Small Scale Industry

The small scale sector has always been given a prominent place in the successive industrial policies. The Government of India in its first Industrial Policy Resolutiou (IPR) 1948. emphasised the role and importance of small scale industries (SSIs) in 'India's economic development.

The IPR, 1956 stressed the role of SSI and re-emphasised that SSI provides immediate large scale employment. It stated that SSI offers a method of ensuring more equitable distribution of national income and facilitate an effective mobilisation of resources. The Industrial Policy Resolution, 1956 kept the entire small scale industry outside the purview of industrial licensing. It underlined the need for modernisation and technological upgradation ol' SSI.

The Industrial Estates Programme was introduced by the Central Government in 1955. The programme was launched with two objectives:

i) promotion of modern small industry through provision of various infrastructural facilities. and economic incentives; and

ii) dispersal of industries away from metropolitan cities through suitable location of industrial estates in rural and semi-urban centres.

In 1977 the responsibility of industrial estates was transferred to state governments.

Afterwards the Government introduced several schemes for the protection and promotion of small industry. These are: reservation of items for production in the small scale sector, reservation of small scale industry items for purchasing by the Government, excise duty concession, concessional finance, etc. A brief description of these facilities is given in section 11.5.2. In addition to these schemes, various institutions were set up lo look after different aspects of the development programmes (Section 11.4).

The Industrial Policy Statement of 1977 has substantially increased the number of items reserved for SSI production. The Industrial Policy Statement ol' 1980 laid guidelines for st-engthening the existing facilities for SSI.

New Policy for Small Industries, 1991

In 1991 the Government announced a separate Industrial Policy for SSI. Until 1991 the policy measures for SSI formed part of general industrial policy. The major thrust of the New Industrial Policy 1991 was on the development of SSIs.

The main features of the new policy are:

i) to allow equity participation up to 24 per cent by other industrial undertakings including foreign companies. This,is to encourage modernisation and technology upgradation.

ii) to encourage complementarity in production programmes of large and small enterprises.

iii) to accord priority to small and tiny sector in allocation of indigenous raw materials.

iv) to provide easier access to institutional finance.

v) to recognize SIDO as the nodal agency to support SSI in export promotion.

vi) to encourage sale of SSI products under common brand names.

vii) to widen the scope of National Equity Fund (for projects upto Rs.10 lakhs).

viii) to enlarge the Single Window Loans (to cover projects upto Rs.20 lakhs). Commercial banks are also to be associated.

ix) to allow private industry to set up industrial estates.

x) to recognize service sector as tiny sector.

It is thus clear that small scale industry has gained increasing importance over the years. The earlier policies have emphasized the importance of small scale industry in India's economic development. The New Industrial Policy of 1991 has, however laid more thrust on the development of small scale sector. Several innovative schemes were announced for improving competitiveness of small scale industry.

11.5.2 .Programmesfor Promotion of Small Scale Industry

The Government has evolved a comprehensive scheme of policies and incentives for the promotion and growth of small-scale industry.

Reservation of Items for Production

The policy of reserving certain product lines exclusively for the small scale sector was introduced in 1967 with 47 products. The number of such reserved items presently stands at 814. Statutory support has been provided to the policy of reservation of items in 1984 through an amendment to the Industrial Development and Regulation Act, 1951.

Reservation of items for exclusive Purchasing from the Small Scale Sector

This policy reserves 410 items for exclusive purchasing by the Government. The needs of Government departments for these 410 items have to be met by purchases from the small scale sector. The Directorate General of Supplies and Disposals (DGS & D) deals with purchases from the small scale sector.

Incentives in Backward Areas

The Central Government has provided several incentives to enable entrepreneurs to establish industrial undertakings in backward areas. These incentives include : concessional finance, subsidy on fixed capital investment, preferential treatment in licensing, etc.

Central Excise Duty Exemption

The excise duty exemption scheme for small scale units was introduced in 1986-87. Under this scheme, presently with effect from 1997-98 full exemption from clearances up to Rs.30 lakhs in a year is granted, a flat rate of duty of 3% on clearances between Rs. 30 lakhs to Rs. 50 lakh and 5%:on clearances up to Rs. 100 lakh is charged.

Most of the state governments have granted sales tax exemption at varying degrees for a wide variety of SSI products,

Ancillary Development Sub-Contracting Exchange

SIDO has set up an Ancillary Development Division at the Central Government level to develop small scale. ancillary and sub-contracting units in the country. Under this 16 sub-contracting exchanges have been set up in SISIs across the country. These exchanges act as an information-house for matching the requirements of buyers in the large scale sector and sellers in the small scale sector.

Marketing Assistance

In order to help the small units to market their products, Small Industries Development Corporations (SIDCs) submit tenders on behalf of small scale industrial units to various agencies including DGS & D, Railways, Defence and State Stores Purchase Authorities including public sector undertakings.

Export Promotion

SIDO provides the following facilities for promotion of exports of SSI products.

i) export marketing information,

ii) export consultancy

iii) organising training courses and seminars on export marketing

Trade delegations and study teams are being sponsored to help the small scale units develop contacts with foreign buyers. Under this programme, 60 per cent of the expenditure incurred hy trade delegations is met hy the Ministry of Commerce under the Marketing Development Assistance Scheme.

Haw **Material** Imports

SIDO plays a major role in assessing the needs and supplying scarce raw materials through imports to SSI. Under the Advanced Licensing Scheme, small units arc able to import raw materials, components and spare parts required for export production without payment of export duty.

Economic **Information**

The Economic Information Division at SIDO provides information on various aspects of small industry development. The Economic Information Division at SISIs provides economic information, cousultancy services. guidance and assistance to small scale units.

Modernisation Programme

The modernisation programme of **SIDO** envisages upgradation of ohsolcte technology through identification of input needs of SSI in rural, urban and backward areas. The main objectives of the programme are:

a) improvement in production technology;

h) product development design;

c) testing, design and quality control;

d) machinery and equipment;

e) selection of proper raw material; and

f) application of improved management technology

More than 20 industries have been selected on All-India basis and about 40 industries on the basis of concentration in different states for intensive programme of modernisation.

Check Your Progress C

1. What were the objectives of Industrial Estates Programme?

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2. Write any three main features of New Policy (1991) for SSIs.

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3. State the main objectives of the modernisation programme of SIDO.

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11.6 LET US SUM UP

The small scale sector plays a significant role in the industrial economy of our country. It has a high potential for generating employment. dispersal of units to semi-urban and rural areas, promoting entrepreneurship and earning foreign exchange. The importance of small scale sector has been highlighted in all the Industrial Policies of the Government.

Over a period, the small scale industry has emerged as a prominent sector in the Indian economy. Its growth has been consistently significant not only in terms of units hut in terms of employment and production us well. The exports from small scale sector account for one-third of the total exports of our country. Thus the contribution of small scale industry to Indian economy in terms of employment generation, industrial production and exports is remarkable.

The organisational pattern of small scale industries, however, places them at a disadvantage which gives rise to various problems. The major problems being faced by these industries include scarcity of raw materials. inadequate finance and credit, marketing constraint, shortage of power and problem of technical know-how.

The Government has evolved an extensive institutional framework and a wide range of policies and programmes for the protection and promotion of small scale industry in India. The New Industrial Policy. 1991 has laid more thrust on the development of small scale industry through innovative schemes.

11.7 ANSWERS TO CHECK YOUR PROGRESS

A. 4. i) entrepreneurship, foreign exchange ii) tiny iii) productive iv) minimisation v) national identity

11.8 TERMINAL QUESTIONS

1. Define a small scale unit? Explain in detail the significanqe and growth of small scale sector in India.
2. What are the major problems being faced hy the small scale industry?
3. Discuss the institutional framework that has been evolved for the growth of small scale industry.
4. Critically evaluate the Government policy towards small scale industries.

Note: These questions will help you to understand the Unit better. Try to write answers for them. hut do not send your answers to the University. These are for your practice only.

SOME USEFUL BOOKS

Francis Cherunilam, *Business Environment,* Himalaya Publishing House. Mumbai.

George Steiner, *Business and Society,* Macmillan. New York.

Indira Gandhi National Open Univeristy, Course Materials — *MS-3: Economic and Social Environment.*

Tandon, *B.B.* & Tandon, K.K., *Indian Economy,* Tata Mc Graw Hill, New Delhi.

UNIT 12 FOREIGN INVESTMENT AND MNCs

Structure

12.0 OBJECTIVES

After studying this unit, you should be able to :

- explain whal is foreign capital and classify its types
- explain the role of foreign capital and its shortcomings
- describe joint ventures and their merits and demerits
- examine the latest government policy
- analyse pros and cons of MNCs.

12.1 INTRODUCTION

For economic and industrial development, capital is the most important factor. Such capital may be from within the country or from outside the country. When capital available within the country is not sufficient, capital from abroad is made use of. For less developed countries, capital has been provided by international organisations like World Bank andnternational Monetary Fund (IMF) at government level. The recent technological developments and spread of information technology have opened up the economies the world over as never in the past. This in turn has increased the muftinational role and importance of capital. It has been realised by many countries that inflow of capital from abroad is vital not only in the early stages of economic development, but also for the growth of a developing economy. Most of the

countries now have been making use of foreign capital and investment. In this unit, we shall first discuss about the meaning and role of foreign capital. Later we shall examine the joint ventures and multinational corporations — their meaning, advantages and disadvantages. The government policy with regard to foreign investment shall also be discussed.

12.2 FOREIGN CAPITAL

The term 'foreign capital' is a comprehensive term and includes any inflow of capital in home country from abroad. It may be in the form of foreign aid or loans and grants from the host country or an institution at the government level as well as foreign investment and commercial borrowings at the enterprise level or both. Foreign capital may flow in any country with technological collaboration as well.

It is interesting to note that even in Russia and East European countries foreign capital has been allowed to flow in. In countries like China, Thailand, Malaysia and Singapore contribution of foreign capital has been extremely encouraging. But in Latin America and African Countries foreign capital flow has not been satisfactory. Foreign capital is useful for both developed and developing countries. Advanced countries try actively to invest capital in developing countries. In India, foreign capital has been given a significant role, although it has been changing overtime. In the early phases of planning, foreign capital has been used as a means to supplement domestic investment. Later on there were technological collaborations between foreign and Indian entrepreneurs. But since July 1991, there has been a tremendous change in government's policy (commonly called liberalisation policy) about foreign investments.

12.3 TYPES OF FOREIGN CAPITAL

Foreign capital can be divided into two types:

1) Foreign Aid

2) Private Foreign Investment

Foreign aid may consist of loans and grants. Private foreign investment takes two forms: a) Foreign Direct Investment (FDI) b) Foreign Portfolio Investment (FPI). In India foreign direct investment may further take the form of (i) wholly owned subsidiary (ii) joint venture and (iii) acquisitions, Foreign portfolio investment may be (i) Investment by Foreign Institutional Investors (FIIs) including Non-Resident Indians (NRIs) (ii) Investment in a) Global Depository Receipts (GDRs) and b) Foreign Currency Convertible Bonds (FCCBs). The above classification is shown below:

- Foreign Capital
  - Foreign Aid
    - Loans
    - Grants
  - Private Foreign Investment
    - Foreign Direct Investment
    - Foreign Portfolio Investment

Private foreign investment in India can be further classified as follows :

- Private Foreign Investment
  - Foreign Direct Investment
    - Wholly owned subsidiary
    - Joint Venture
    - Acquisitions
  - Foreign Portfolio Investment
    - Investment by Foreign Institutional Investors and NRIs
    - Investment in (a) GDRs (b) FCCBs

Let us discuss them ont: by one.

Foreign Aid: It consists of loans and grants. Loans may be taken from individual countries or from institutional agencies like World Bank, IMF and International Financial Corporation.. Usually loans are taken for medium and long term capital needs of a country. Loans impose a heavy burden on the borrower country because they are to he repaid, along with interest, called surviving of loans. Loans may be tied because of restrictions. Such restrictions may hc in the form of end use or in the form of source. Grants are given by public or private charitable organisations. They are given for relief purposes and immediate use. Grants may he time bound and can be used only for specific purpose. Loans involve repayment obligations, where as grants are not refunded. It is important to see that grants are properly utilised for the specified purpose.

Any foreign capital in the form of aid should be pledged on the basis of its purpose, mode of repayment, cost to the borrower and political considerations. For it is not only uncertain, usually not extended for public sector but for consumer goods industries and do not create means for its repayment. It is therefore better to create 'trade' rather than 'aid' from a foreign country.

Private Foreign Investment : It is of two types: 1) Foreign Direct Investment 2) Foreign Porlfolio Investment

You should note that foreign investment and collaboration with a foreign nation are closely interrelated, but they are different from each other. Capital investment is participation of a foreign country in capital of recipient country's enterprises. Collaboration, on the other hand, means providing technical and managerial know how, licensing franchise, trade marks and patents by a host country to home country. Lel us now discuss the two major components of private foreign investment

12.4 FOREIGN DIRECT INVESTMENT

It is also known as 'direct business investment'. Foreign direct investment (FDI), according to IMF manual on 'Balance of payments' is "all investment involving a long tam relationship and reflecting a lasting interest and control of a residual entity in one economy in an enterprise resident in an economy other than that of the direct investor. Such investment involves both initial transaction between the two entities and all subsequent transactions between them and among foreign affiliates". Foreign affiliate means a suhsidiary company or an associate in which investor owns a total of at least 10%, hut not more than half of shareholder's voting power or branches,

From the above definition we notice ttic following characteristics of FDI :

1) It is an investment made by a foreign company in a home country.

2) The foreign company may make an investment either by opening its branch or by having a suhsidiary or foreign controlled company in home country. It may have wholly owned suhsidiary or joint venture or may acquire a stake in the existing business.

3) Profit is the prime motive of such an investment. It may be in the form of a royally and dividend payments.

4) Inveslor retains control over investment and management of the firm concerned. In FDI investor may obtain efective voice in the management through other means such as subcontracting, management contracts, turnkey arrangements, franchising, licensing, trade marks and patents and product sharing.

5) On the winding up of the firm, the assets may he repatriated to the country of origin.

According to Seclion. 591 of the Indian Companies Act 1956, a foreign company means any company incorporated outside India which established a place nf business within India after or before 1.4.1956. The Reserve Bank of India has classified foreign companies into three types:

a) subsidiaries in which a single foreign company holds more than 50% of the equity share capital

b) minority companies in which foreign company holdings arc 50% or less,

c) purely technical collaboration companies which have no foreign equity participation They have only technical collaboration agreements.

Foreign companies are also governed by Indian Income Tax Act 1961, MRTP Act 1969, Industrial (Development and Regulation) Act 1951, and Foreign Exchange Regulation Act, 1973.

FDI are governed by long term considerations because these investments cannot be easily liquidated. In aiming at investment decision, a foreign investor would have to he convinced that existing comparative advantages are more than the comparative disadvantages in a country. Hc will compare the improved investment climate in one country with investment markets in another country. There are many other factors that Influence FDI decisions. They are: a) long-tern political stability b) government policy of a country c) industrial and economic prospects d) rules about repatriation of profits and disinvestment e) treatment by officials in government departments and f) taxation laws.

The recipient counuy should he cautious that FDI may be harmful if the economy is highly protected and foreign investment takes place behind high tariff walls.

12.5 PORTFOLIO INVESTMENT

Portfolio investment is an investment in a foreign country where the investing party does not seek control over the investment. It takes the form of the purchase of equity in a foreign stock market or credit or capital from private or official sources. If we analyse the ahove definition we find the following features of portfolio investment:

1) The investor purchases the equity in a foreign stock market i.e., he has a sort of property interest

2) The equity includes shares (stock) and creditors capital (debentures/bonds/other securities)

3) The equity purchased is of a joint stock company

4) The investor is a non-resident

5) If it is creditors capital, it may be from private or official sources and is invested in recipient country's Joint stock companies

6) The investor does not seek control over the investment if they do not have involvement with promotion and management of joint stock company

Two more characteristics may be added here:

a) Portfolio investment can be liquidated fairly easily.

b) Portfolio investments are influenced by short term gains and are more sensitive than FDI.

There are mainly two forms ofportfolio investment in India a) by foreign institutional investors (FIIs) like mutual funds b) investment in global depository receipts (GDRs) and foreign currency convertible bonds (FCCBs).

A) Foreign Institutional Investors (FIIs)

Indian Stock Market was openedup to FIIs in 1992-93. FIIs include pension funds, mutual funds, asset management companies, investment trusts, nominee companies and corporate or institutional managers. The regulations on FIIs, notified on November 14, 1995 by RBI, contains various provisions relating to definition of FIIs' eligibility criteria, investment restrictions, procedure of registration and general obligations and responsibilities of FIIs. They may invest only in:

a) securities in the primary and secondary markets including shares, debentures and warrants of companies listed on a recognised stock exchange in India; and

b) units of schemes floated by mutual funds including Unit Trust of India, whether listed or not.

In 1996-97 the Government of India liberalised investment policy hy FIIs. There is no reslriction on the volume of investment and no lock-in period. Disinvestment is allowed only through stock exchanges in India. The holding of a single FII in any company would be

subject to a ceiling of 10% of total equity capital. They have to pay tax on concessional rate on capital gains. They can invest in unlisted conlpanies, in corporate as well as government securities.

The greatest disadvantage of investment by FIIs is that it is not certain how long they will hold their investment, If they are allowed to acquire more of a company's equity (at 25%), they can pressurise courtly interests of most companies. They may engage in speculative investment, avoid tax laws due to double-taxation treaties and take undue advantage of exchange rates. This can be prevented by improving the functioning of the stock markets. The Government has to adopt apolicy by which FIIs may not benefit at the cost of Indians.

Investment **by NRIs**

Non-Resident Indians are the persons not residing in India. They are of two types: a) an Indian citizen who i) has made his permanent home outside India or ii) has proceeded abroad for employment or gainful occupation, b) an Indian citizen who made his permanent home outside India and acquired foreign citizenship or the descendent of an Indian who had earlier migrated from undivided India.

This definition has been extended and includes a foreign born husband of a citizen of India. Investment made by NRI of category (a) are allowed to invest liberally, Investment by NRI of category (h) are subject to policy guidelines framed by thc government of India, The RBI has given a general exemption to NRI for transfer of sharcs/debentures/bonds of Indian conlpanies through recongnised stock exchange. They can gifl the shares etc. to their close relatives. They can invest funds in government securities or units of UTI. NRIs and Overseas Corporate Bodies (OCBs) predominantly owned by NRIs can acquire listed securities of Indian Companies upto 24% of their paid up capital under porlfolio investment scheme. They can make direct investment upto 100% of the equity in industrics mentioned in Annexure III of the New Industrial Policy 1991. There is a single window facility available lo NRIs for obtaining all information about investments in India. There is automatic clearance for investment proposals of NRIs for the industries mentioned in Annexure III.

B) Global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds **(FCCBs)**

GDRs and FCCBs are investments issued by Indian companies in Euro or US markets for mobilising foreign capital by facilitating portfolio investment.

A GDR can be defined as i) an instrument, ii) expressed in dollars, iii) traded on stock exchange in Europe or US and iv) represents a certain number of equity shares. These equity shares are, however, denominated in rupees.

The procedure of GDR is as follows: First the equity shares are issued by the company to an inlermediary, called 'Depository', The shares are registered in the name of depository, It is the deposilory that issues GDRs. The depository also has the agent and the actual possession of equity shares is with the agent. The agent is called 'custodian'. Then GDR does not figure in the books of the issuing company.

FCCBs, are also called 'Euro Convertible Bonds'. They are quasi debt securities i.e. they can be converted into a 'depository receipt' or local shares. The investor has the option to convert the bonds into equity shares at a fixed price after a minimum period. The exchange rate for the conversion price is fixed as is the conversion price.

There are two types of options — 'Put option' and 'Call option'. Put option is the right given to the investor and call option is the right given to the company. By put option the investor has a right to gel his money back before maturity, either at par or at 100% basis point over the US tresury rate at the time of issue. By call option the company has a right to convert bonds into shares, if the market price of the shares exceeds a particular percentage of the conversion price. Since 1993 these bonds have become popular.

12.6 ROLE OF FOREIGN CAPITAL

In the early stages of industrialisation in any country foreign capital plays an important role. Their role can he better understood under the following heads:

1) Increase **in** Resources: Foreign capital not only provide an addition to the domestic savings and resources, but also an addition to the productive assets of

the country. The country gets foreign exchange through FDI. It helps to increase the investment level and thereby income and employment in the recipient country.

2) **Risk Taking:** Foreign capital undertakes the initial risk of developing new lines of production. It has with it experience, initiative, resources to explore new lines.. If a concern fails, losses are borne by the foreign investor.

3) **Technical Know-how:** Foreign investor brings with him the technical and managerial know how. This helps the recipient country to organise its resources in most efficient ways i.e. the least costs of production methods are adopted. They provide training facilities to the local personnel they employ.

4) **High Standards:** Foreign capital brings with it the tradition of keeping high standards in respect of quality of goods, higher real wages to labour and business practices. Such things not only serve the interest of investors, but they act as an important factor in raising the quality of product of other native concerns.

5) **Marketing Facilities:** Foreign capital provides marketing outlcts. It helps exports and imports among the units located in different countries financed by the same firm,

6) **Reduces Trade Deficit:** Foreign capital by helping the host country to increase exports reduces trade deficit. The exports are increased by raising the quality and quantity of products and by lower prices.

7) **Increases Competition:** Foreign capital may help to increase competition and break domestic monopoly. Foreign capital is a good barometer of world's perception of a country's potential.

It is rightly said that a satisfied foreign investor is the best commercial ambassador a country can have. To sum up, foreign capital helps three important areas that are necessary for the economic development of a country. These three areas are savings, trade and foreign exchange and technology. Foreign capital performs three gaps filling function i.e, i) savings gap ii) trade gap iii) and technological gap in the recipient country's economy. It encourages development of technology, managerial expertise, integration with other economies of the world, export of goods and services and higher growth of country's economy.

Short comings of foreign capital

The following criticisms are levelled against foreign capital:

1) It may flow-to the high profit area rather than the priority sector.

2) The activities of foreign investors may be inimical to the national interest. It may interfere in the national politics or may engage in unfair trade practices or may impose restrictive conditions.

3) It increases dependence on foreign resources. First in the use of foreign technology and second the foreign technology used requires import of goods for replacement and maintenance that are costly. There may be intensity of foreign capital.

4) Often the profit earned in early stages are high involving big remittances. Foreign investor may recover his amount in a relatively short time. Yet the payment on account of such things as technical services, royalty payment etc; continues.

5) There may be adverse effects on income distribution in the country, transfer pricing and balance of payments.

Though there are arguments for and against foreign capital and statistics are available to support both points of view, yet the role of foreign capital can not be ignored. We will study more details about foreign capital in the next unit.

12.7 GOVERNMENT POLICY

The Industrial Policy Resolution 1948 was the first step that emphasised the need for regulating as well as inviting private foreign capital. On April 6, 1949 the Government issued a statement

on policy towards foreign capital. The main principles of the policy towards foreign capital was that foreign capital would be treated at par with Indian capital, profit will be allowed to be remitted and adequate compensation shall be paid on acquisition of any foreign enterprise. In 1970 the role of foreign capital was restricted to core, heavy and export oriented industries. In 1980, some liberalisation was introduced towards foreign collaboration.

A new policy statement was made on July 1, 1991, by which foreign technology agreements was to be encouraged, approval for FDI up to 51% equity in high priority industries was allowed and a special board was set up to negotiate with foreign firms.

In 1996-97, following changes have been effected in respect of foreign investments:

1) The list of industries eligible for automatic approval up to 51% foreign equity has been increased to 48 as against 35. In mining industries it is 50% foreign equity and in 9 categories of industries it is up to 74% foreign equity allowed for automatic approval.

2) Foreign Investment Promotion Council (FIPC) and Foreign Investment Promotion Board (FIPB) are to prepare project reports and make foreign investment rules more transparent respectively.

3) FIIs are allowed to make equity investment in unlisted companies.

4) Guidelines have been issued in 1097 for consideration of foreign investments for proposals not covered under automatic route areas where 100% foreign equity is allowed and priority areas for FDI. Some of the guidelines are as follows:-

   a) The priority areas are i) infrastructure, ii) large scale employment potential, specially for rural areas iii) export potential iv) items linked with farm sector v) social sector projects like hospitals, medicines and health care.

   b) The approvals will be subject to following limits :

   — Banking Sector— 20% (40% for NRIs)

   — Non banking financial companies —— 51% (100% with specified minimum levels of foreign investment)

   — Power, Ports, Roads, Tourism and venture capital funds ——100%

   — Tele communications —— 40%

   — Airlines/Air taxi —— 40% (100% for NRI)

   — Small Scale Industries —— 24%

   — Drugs and Pharmaceuticals —— 51%

   — Petroleum —— 100%

   — Mining —— 50% (Except for gold, silver and diamonds)

   c) Where the foreign company is not able to find a suitable Indian joint venture 100% foreign equity is allowed provided foreign company will divest at least 26% of its equity in favour of Indian party within 3 to 5 years.

   d) Proposal for 100% trading firms for exports, bulk imports, cash and carry wholesale trading and other import of goods and services is allowed if at least 75% is for sale among group firms.

   e) Foreign firms are allowed to set up 100% equity companies on the following basis:

      i) Where only holding operation is involved and all downstream investments to be carried out need prior approval

      ii) Where at least 50% of production is exported

      iiii) Consultancy proposals

      iv) Projects in power, ports, roads and industrial towns and estates

   v) Where sophisticated technology is to be brought in.

Recently the Government has opened 26% foreign equity participation and 14% for NRI in insurance sector.

The response of foreign investors to the policy has been encouraging. For example FDI in 1996-97 were $2696 million as against $ 129 million in 1991-92. The portfolio investment were $3312 million in 1996-97 as against $ 158 million in 1991-92. NRI deposits have grown from about $ 63 million in 1991-92 to US $ 639 million by 1996-97. 435 FIIs were registered with SEBI by October 1996. There were about 177 joint ventures in operation by the end of 1995, involving Indian equity of Rs 179 crores. It shows foreigners are showing greater confidence in India's investment climate. The new policy of the government is, of course, much better than the old policy. Ever since liberlisation most of the foreign investment has been in priority sectors. Table 12.1 gives the latest position of foreign investment.

Table 12.1: Foreign Investment Flows

(US $ Millions)

	91-92	92-93	93-94	94-95	95-96	96-97	97-98
A. Direct Investment	129	315	586	1314	2133	2696	3197
i) RBI automatic route	—	42	89	171	169	135	202
ii) SIA/FIBB route	66	222	280	701	1249	1922	2754
iii) NRI(40% and 100%)	63	51	217	442	715	639	241
B. Portfolio Investment	4	244	3567	3824	2748	3312	1601
i) FIIs .x.	—	1	1665	1503	2009	1926	752
ii) Euro equities (GDRs).x..x.	—	240	1520	2082	683	1366	645
iii) Offshore funds and other	4	3	382	239	56	20	204
Total	**133**	**559**	**4153**	**4153**	**5136**	**4881**	**4796**

.x. Figures represent fresh inflows of funds by FIIs

.x..x. Figures represent GDRs amounts raised abroad by Indian Companies.

Source: Economic Survey 1997-98

Check Your Progress A

1. What is foreign capital?

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2. What are the various forms of foreign capital?

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3. State whether the following statements are True or False?

   i) Foreign direct investment is an investment where the foreign party retains control over the investment.

   ii) Portfolio investment is an investment where the foreign party does not seek control over the investmenl.

   iii) GDRs is a convertible bond.

   iv) FCCBs can be converted into GDRs.

   v) Foreign capital may take place either in the form of foreign aid or private investment.

12.8 JOINT' VENTURES

There are three factors that determine global joint ventures (JVs) and foreign direct investment. **First** is the ownership advantage in the form of monopoly over a product or brand name, a patent on a production process or technology or a superior knowledge of the market and marketing techniques. **Second** is that the host country may have some locatibnal advantage in terms of serving its market or an export base, or low wage labour and low transportation cost etc. **Third** is the condition that makes the foreign market more profitable than internal market.

12.8.1 Meaning

Joint venture includes commercial and industrial enterprises in which two or more parties from two or more countries share responsibility for operation. They provide risk capital, goodwill, know how and management and natural resources. There is a controlling partner in joint venture who is a major decision maker. A joint venture in simple words, is an enterprise which is jointly owned and managed by a local entrepreneur and a foreign entrepreneur. Ajoint venture can be formed by starting a new firm or by buying an interest of a firm in a host country by a foreign firm and vice versa. Thus a joint venture is any form of association which implies collaboration for a long period between local and a foreign firm. The earliest joint ventures between developed and developing countries were in mining and plantation.

12.8.2 Types of Joint Ventures

Joint ventures may be investment oriented or non-investment oriented. Non investment oriented joint ventures involve like use of brand name or to develop a source of supply of raw material for parent firm's use. In case of investment oriented joint ventures a foreign firm participates in local firms equity, which may be minority or majority equity. Many combinations of joint ventures have emerged. Following are some examples:

a) A foreign private company and a local state government.

b) One foreign company joining with a local company.

c) **A** government controlled company with joint ventures abroad.

d) Two firms of one foreign country joining together in a foreign market.

e) Companies from two or more countries forming a joint venture in a third country.

f) More than two nations in one joint venture.

12.8.3 Advantages

Joint ventures have the following advantages:

1) They are an alternative where a country does not allow fully foreign owned firms.
2) They help a local firm to enter foreign markets.
3) They make possible the use of know how, patent etc.
4) They help to enhance foreign exchange earnings.
5) The local firm can easily approach the national government and the public.
6) They help diversification of business risk among two countries.

12.8.4 Disadvantages

From the point of view of host country joint ventures may bring some disadvantages also. Some of them are as follows:

1) The subsidiaries in host country may he allowed to use only limited or outdated technology or may dump unwanted technology or even banned products.
2) The local skilled technical personnel may he restricted from learning process or to take over key positions. This may lead to drawing away talented personnel.
3) Respect for local social customs and traditions may not be shown. They may be acting against objectives of national plans or may manipulate laws by bribing officials.

4) They map dominate some key industrial sectors. Due to monopolistic advantage they may be extracting high profits and fees. Producing unnecessary goods with scarce resources may lead to inflation.

5) They may divert local savings away from 'productive investment by nationals. The equipments or spare parts to be exported may be over invoiced. The financing may be mainly through local debt.

To overcome these disadvantages the government of host country may change their policy towards joint ventures from time to time. Some of the steps a government may take; are like limiting equity participation, keeping nationals on hoard of directors, placing ceiling rates on royalties and percentage of profits and raising debt outside local capital market.

12.8.5 Indian Joint Ventures

In the beginning of 199'5 there were 177 Indian joint ventures in operation involving total equity of 179 crores. In addition, 347 other ventures were under implementation involving Indian equity of about 1400 crores. Indian joint ventures are mostly in south-east Asia and in Africa. These countries are mostly middle income countries like Sri Lanka, Nigeria, Kenya, UAE, Thailand, Uzbekistan and Uganda. The Indian joint ventures are mostly in engineering, construction, textiles, chemicals, electrical, paper and glass and shipping. They have been undertaken by private entrepreneurs and public sector undertakings.

But there has been a high failure rate of these ventures: One because of delays in clearance by the Government and secondly because their objectives were not clearly defined. The government has recently liberalised its policy in regard to setting up joint ventures abroad. Now automatic clearance wili be given to Indian entrepreneurs for joint ventures proposals. It has issued fresh guidelines on 17-8-95. These guidelines are for firms engaged in industrial activity, trading or services such as hotel, tourism and financial services. Banking businesses are not covered by these guidelines. According to it, Indian direct investment abroad below $ 4 million will be cleared by RBI under the 'fast track' route scheme within 21 days. Investments above this amount will be processed by a special committee consisting of representatives of the Ministries of finance, commerce and external affairs. Under fast track scheme approval is given only if the investment does not exceed 25% of the annual average export earnings of Indian company during the preceding three years. Within five years from investment time full invested amount will be repatriated by way of dividend and royalty. Financial services must have a three years track record of minimum net worth of Rs. 15 crore and prudential norm of 8% capital adequacy. The project statement is to be verified by a chartered accountant.

Since 1995, a new trend to set up overseas investment companies by Indian firms has been started in tax heavens like e.g. in British Virgin Islands. Birlas are on top in respect of Indian investors abroad- followed by Thapars, Tatas, J&K group, Modies, HMT, Usha, Martin Black, Oberoi Hotels, Larsen and Touhro and Kirloskars.

12.9 MULTINATIONAL CORPORATIONS (MNCs)

In modern times large corporations have become major carriers of foreign capital and technical know-how. They are known by various names such as: i) Multinational Corporations, ii) Transnational Corporations, iii) International Corporations, and iv) Global Corporations. These terms are sometimes used as synonyms.

In early days USA was the centre of most of MNCs. But now Japaneese and European MNCs are also emerging. The first MNC came to India in 1921. Singer sewing machines of USA came to England in 1862-63.

12.9.1 Definition

There is no universally accepted definition of the term MNC. MNC can be defined as a company (a) which has a direct investment base in several countries, b) which generally derives from 20% to 50% or more of its net profits from foreign operations, and c) whose management makes a policy decision based on the alternatives available anywhere in the world. A firm becomes MNC on the basis of its size, performance, structure and behaviour. They are usually organised around a national headquarter from which international control is exercised.

The term MNC differ from international corporation. The later is a company with manufacturing investment (or service operation) in at least one country, while MNCs have direct investment in several countries and considerable share is in foreign countries. The transnational corporations (TNCs), are incorporated or unincorporated enterprises comprising parent enterprises and its affiliates. TNC is a multinational company in which both ownership and control are so dispersed internationally. There is no principal domicile and no one central source of power. The term 'global corporation' is also often used to mean more or less the same thing as TNC. However there is a view that global corporation is one which considers the entire world as single market in which globally standardised products are sold.

MNC as a company has following five criteria:

1) It operates in many countries at different levels of economic development.
2) Its local subsidiaries are managed by nationals.
3) It has a multinational stock ownership.
4) It has a multinational central management.
5) It maintains complete industrial organisations, including research and development and manufacturing facilities in several countries. .

The managing headquarters of MNCs are located in one country (home country), while enterprise carries out operations in a number of other countries (host country).

There are many reasons that motivate a company to go for international investments. Some of them are as follows:

1) to reduce'the impact of tariffs.
2) to reduce the cost of production. This is done by use of cheap labour or material cost or transport costs.
3) to gain a greater share in a foreign market or to combat competition.
4) to exploit natural resources of the host country.
5) to reduce the impact of strict trade and industry rules and regulations of home country, for example pollution laws.
6) to enjoy benefits of tax exemptions.

12.9.2 Characteristics of MNCs

a) **Giant Size:** The assets and sales of MNCs run into billions of dollars. In terms of total assets General Electric (US) and in terms of foreign assets Royal Dutch Shall (UK/Netherland) are the largest among 50, Mitsui (Japan) ranks top in terms of total sales. Some MNCs have their assets more than GNP of some countries.

b) **International Operations:** An MNC operates through a parent corporation in home country. It may have a branch or a subsidiary. It is called affiliate. The control may range between 20% to' 100%.

c) **Oligopolistic Structure:** Because of its giant size, it is able to acquire control through merger or takeover. Thus it becomes oligopolistic in character.

d) **Collective Transfer of Resources: An** MNC has the facilily of transfer of resources in the form of 'package'. It includes technical know how, equipment and machinery, managerial skill and raw materials etc.

e) **Growth:** An MNC can grow at a faster rate because of wage differences, and availability of opportunities in a host country. The economic dominance, investment in developed economies and increase in world trade are other features of MNCs.

12.9.3 Merits

1) They provide technological and managerial know-how to underdeveloped countries.
2) They increase the investment level by providing capital from developed countries and also help to provide increase in income and employment to people in host countries by opening their branches or subsidiaries.

3) They help to break the monopolies. They also help domestic suppliers.

4) They act as a 'linkage' to other industries in underdeveloped countries and such linkage is either backward or forward.

5) They provide management technology and thus build up a 'knowledge box' They help research and development (R&D).

6) They help in creating favourable balance of payments in host countries by helping to increase exports and decrease imports. They are 'global scanner'

12.9.4 Demerits

.Following are some of the objections raised against MNCs:

1) They relatively create few jobs and do not help in solving unemployment problem in a host country.

2) They bring such technology which underdeveloped countries cannot easily adopt. So these countries have to permanently depend upon them for such technology.

3) The expenditure on R &D by MNCs is negligible. The transfer of technology may sometimes be very costly.

4) The dividend, royalties, professional services and technical know how are paid in hard currency. This puts a drain on the foreign exchange of the host country. They may resort to devaluation of their currency.

5) MNCs sometimes become monopoly. They may direct their profits to their wholly owned subsidiaries.

6) They may participate in non-essential and consumer goods,

7) They may resort to undesirable and unfair trade practices through rigging of bids, price discrimination, price fixing etc. This is because they are oligopolistic in character.

However, above dangers from MNCs can be minimized by a host country's cautious policy of the government. There may be a threat of nationalisation. The Government may allow collaboration in selected industries or investment for a specific period and may impose high tax on their income. It may lay down export criteria as well. The Brandt Commission recommends a code of conduct relating to multinational enterprises.

MNCs are not criticized so much as was in the past. Developing countries are now encouraging MNCs. Countries are making bilateral practice to promote and protect FDI. Privatisation policies offer new opportunities for foreign investors.

However, Indian companies so far have not made significant foreign investment outside. Comparatively very little foreign investment has taken place in India. The Government of India's new pdlicy is expected to encourage foreign investments, Foreign Exchange Regulation Act 1973 is being replaced by Prevention of Money Laundering Act and Foreign Exchange Management Act.

Check Your Progress B

1. Define the terms Joint Venture and MNC.

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2, What are the various types of Joint ventures?

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3. Point out some characteristics of MNCs.

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12.10 LET US SUM UP

Foreign capital include any inflow of capital in home country from abroad. It may be in the form of foreign aid or loans and grants at government level as well as foreign investment and commercial borrowing at the enterprise level or both. Foreign capital is of two types: 1) foreign aid and 2) private foreign investment. Foreign private investment can he divided into a) foreign direct investment, b) foreign portfolio investment. FDI may be in the form of joint ventures. wholly owned subsidiary or acquisitions. FPI includes investment by foreign institutions, NRIs. and in GDRs/FCCBs. Foreign capital plays an important role in the development of a country. Its role is seen in a) increase in the resources, b) risk taking, c) technical know how, d) high standards, e) marketing facilities, f) reducing trade deficit and, g) increasing competition. Foreign capital is criticized on certain grounds like that it may be against national interest, may be invested in low priority areas, affecls balance of payments and income distribution. The Government policy of 1991, along with changes announced in 1996-97, have been encouraging foreign investments.

Joint ventures include commercial and industrial enterprises in which two or more parties from two or more countries share responsibililies for operation. They provide risk capital, goodwill, know how and management and natural resomces. It may lake many forms.

Large Corporations are known by many names such as MNCs, transnational corporations, global corporations and international corporations. MNC is defined as a company which has a direct investment base in several countries and which generally derives 20% to 50% or more of its net profits from foreign operations and whose management makes a policy decision based on alternatives available anywhere in the world. MNCs have the characteristics such as giant size, international operations, oligopolistic structure, collective transfer of resources and growth. MNCs have been favoured as well as criticised on many grounds. Of late, their role has been appreciated and developing countries are establishing more MNCs,

12.11 KEY WORDS

Foreign Direct Investment **(FDI):** FDI refers lo investment in a foreign country where investor retains control over the investment.

Foreign Institutional Investors **(FIIs):** These are financial institutions who invest money in a foreign country.

Foreign **Currency** Convertible Bonds **(FCCBs):** They are quasi debt securities. The investor has option lo convert these bonds into depository receipt or equity shares at a fixed price after a certain period.

Global Depository Receipts (GDRs): It is an instrument whose value is denominated in dollars and is traded both in USA and Europe. The company issncs shares to a depository, who then issues GDR. Thus it represents the issuing companies shares.

Joint Venture: It includes commercial and industrial enterprise in which lwo or more parties from two or more countries share the operation responsibilities in an undertaking.

Multinational Corporation: It is that corporation which owns and controls business or commercial undertakings in more than one country.

Non-Resident **Indian:** They are Indians who are not residing in India.

Portfolio Investment: It means an investment in a foreign country where the investing party does not seek control over the investment.

12.12 ANSWERS TO CHECK YOUR PROGRESS

A 3. i) False ii) True iii) False iv) True v) True

12.13 TERMINAL QUESTIONS

1. In what forms the foreign capital flows in a country?
2. "Foreign capital is dangerous and should not he allowed." Do you agree with this statement? If not why?
3. What are the main considerations that make an enterprise to be called an MNC? Are there any benefits of MNCs?
4. Point out the special features of FDI.
5. Define a joint venture. Discuss their merits and demerits.

Note: These questions will help you to understand the Unit better. Try to write answers for them, but do not send your answers to the University. These are for your practice only.

UNIT 13 INDIA'S FOREIGN TRADE

Objectives

This unit facilitates the understanding of the

- need for foreign trade;
- growth trends in India's foreign trade;
- changing composition of India's imports and exports;
- destination of India's exports and origin of India's imports; and
- implications of India's foreign trade growth.

Structure

13.1 INTRODUCTION

Foreign trade or international trade refers to the trading of goods between countries. Thus, international trade is an extension of internal trade i.e., trade between two different regions within a country. Just like as single region within a country cannot produce everything it needs by itself, one single economy cannot produce every commodity all by itself. This could be due to differences in the availability of natural resources, skills of people, etc. Therefore, it would be advantageous for a country to indulge in trade with other countries, by exporting those commodities which it produces cheaper in exchange for what others can produce at a lower cost.

Foreign trade also facilitates the dissemination of technical knowledge, transmission of ideas, and import of know-how/skills, managerial talents and entrepreneurship. In addition, foreign trade encourages movement of foreign capital. In totality, foreign trade can have a profound impact on the growth of an economy in terms of production, employment, technology, resource utilisation and so on.

13.2 INDIA'S FOREIGN TRADE: TRENDS

The origin of India's foreign trade can be traced back to the age of the Indus Valley civilisation. But the growth of foreign trade gained momentum during the British rule. During that period, India was a supplier of food stuffs and raw materials to England and an importer of manufactured goods. However, organised attempts to promote foreign trade were made only after Independence, particularly with the onset of economic planning. Indian economic planning completed five decades. During this period, the value, composition and direction of India's foreign trade have undergone significant changes.

India's foreign trade has come a long way since 1950-51. The values of both exports and imports have increased several times over the period (Table 13.1). The value of exports rose from Rs. 606 crore in 1950-51 to Rs. 1,06465 crore in 1995-96. The value of imports, during the same period, increased from Rs. 608 crore to Rs. 1,21647 crore. With the exception of 1971-72 and 1976-77, the value of India's imports has always been higher than that of exports.

Table 13.1: India's Foreign Trade: Trends

(Rs. in Crores)

Year	Exports	Growth Rate	Imports	Growth Rate	Trade Balance
1950-51	606	—	608	—	–2
1951-52	716	18.2	890	46.4	–174
1952-53	578	–19.3	702	–21.1	–124
1953-54	531	–8.1	610	–13.1	–79
1954-55	593	11.7	700	14.8	–107
1955-56	609	2.7	774	10.6	–165
1956-57	605	–0.7	841	8.7	–236
1957-58	561	–7.3	1035	23.1	–474
1958-59	581	3.6	906	–12.5	–325
1959-60	640	10.2	961	6.1	–321
1960-61	642	0.3	1122	16.8	–480
1961-62	660	2.8	1090	–2.9	–430
1962-63	685	3.8	1131	3.8	–446
1963-64	793	15.8	1223	8.1	–430
1964-65	816	2.9	1349	10.3	–533
1965-66	810	–0.7	1409	4.4	–599
1966-67	1157	42.9	2078	47.5	–921
1967-68	1199	3.6	2008	–3.4	–809
1968-69	1358	13.3	1909	–4.9	–551
1969-70	1413	4.1	1582	–17.1	–169
1970-71	1535	8.6	1634	3.3	–99
1971-72	1608	4.8	1825	11.7	–217
1972-73	1971	22.6	1867	2.3	104
1973-74	2523	28.0	2955	58.3	–432
1974-75	3329	31.9	4519	52.9	–1190
1975-76	4036	21.2	5265	16.5	–1229
1976-77	5142	27.4	5074	–3.6	68
1977-78	5408	5.2	6020	18.6	–612
1978-79	5726	5.9	6811	13.1	–1085
1979-80	6418	12.1	9143	34.2	–2725
1980-81	6711	4.6	12549	37.3	–5838
1981-82	7806	16.3	13608	8.4	–5802
1982-83	8803	12.8	14293	5.0	–5490
1983-84	9771	11.0	15831	10.8	–6060
1984-85	11744	20.2	17134	8.2	–5390
1985-86	10895	–7.2	19658	14.7	–8763
1986-87	12452	14.3	20096	2.2	–7644
1987-88	15674	25.9	22244	10.7	–6570
1988-89	20232	29.1	28235	26.9	–8003
1989-90	27681	36.8	35416	25.4	–7735
1990-91	32553	17.6	43193	22.0	–10640
1991-92	44042	35.3	47851	10.8	–3809
1992-93	53688	21.9	63375	32.4	–9687
1993-94	69547	30.4	72806	15.7	–3259
1994-95	82338	18.4	88705	21.8	–6375
1995-96	106465	29.3	121647	37.1	–15182
1996-97	118817	138920	–20103	11.7	13.2
1997-98	130100	154176	–24076	9.5	11.0
1998-99	139752	178332	–38580	7.4	15.7
1999-2000	159561	215236	–55675	14.2	20.7
2000-01	203571	230873	–27302	27.6	7.3
2001-02	209018	245199	–36181	2.7	6.2

Source: *Economic Survey*, 1995-96 & 2002-03.

As a result, India has been a trade deficit country. Another aspect of India's foreign trade is the fluctuating growth rates of exports and imports. The growth rate for exports ranged from as low as – 19.3 percent in 1952-53 to 42.9 precent in 1966-67. Similarly, the growth rate of imports varied from 21.1 percent in 1952-53 to 58.3 percent in 1973-74.

Imports: During 1950s, the value of trade increased only marginally. The value of exports, remained the same, more or less. But the value of imports, with certain fluctuations, increased by about 60 percent during the decade. The significant rise in imports was largely due to the increase in the quantum of imports of food grains, raw materials, capital equipments and machinary. The emphasis on heavy industries during the second Five Year Plan necessitated the imports of machinery and capital equipments which contributed to the increase in the value of imports.

The emphasis on heavy industries continued during the third Five Year Plan and the three Annual Plans. This resulted in increased imports of machinery and machine products. The bad weather conditions in the sixties led to more imports of food grains and agricultural raw materials. Added to these, the devaluation of the Indian rupee in 1966 further raised the value of imports. As a result, the value of imports rose by about 40 percent during 1960.

It was during the seventies that the value of imports went up sharply. This was largely due to the hike in the prices of petroleum and petroleum products effected by the Organisation of Petroleum Exporting Countries (OPEC) in 1973-74 and then in 1979 and 1980. That is why the value of imports registered an increase of 58 percent in 1973-74, 53 percent in 1974-75, 34 percent in 1979-80, and 37 percent in 1980-81. During 1970-71 to 1979-80, the value of imports increased by more than 500 percent. In addition to the oil price hike, the general inflationary trends prevailing in the international market also contributed to the increase in the value of imports.

The increase in domestic production of crude oil in the eighties slowed down the increase in the value of imports, as the relative share of petroleum products in the country's import bill marked a decline. However, during the late eighties, partly due to an increase in the quantum of petroleum products imported and partly due to a rise in the international oil prices, the value of imports once again increased sharply. The 'Gulf crisis' in 1990 and the currency devaluation in 1991 further pushed up the country's import bill. On the whole, in the post-Independence period, during the sixties and seventies, import of food items and capital goods contributed to the growth of imports. But since the eighties Petroleum products and capital goods determined the growth trends in the value of imports, to a large extent.

However, the growth of imports in the nineties has been characteristically different from the earlier period, especially from the policy point of view. In 1991, the Indian Government initiated a major import liberalisation programme as part of its what is now commonly known as the New Economic Policy. Import liberalisation consisted of gradual reduction of import tariffs and elimination of import restrictions.

Major reductions in tarrifs have been introduced in the nineties. The import-weighted average tariff for the whole economy fell from 76.7 percent in 1990-91 to 40 percent in 1993-94, which further fell in 1994-95. The peak rate of tariff which was as high as 220 percent in 1991 has now been brought down to 65 percent.

Import licensing has been virtually scrapped for new materials, intermediate components and capital goods. These can now be freely imported subject to a “negative list” which is under constant review and has been substantially pruned in the nineties.

Due to these policy measures, the relative share of raw material, intermediate and capital goods imports went up particularly in 1993-94. However, due to slowdown in industrial growth, capital goods imports have declined in the first quarter of 1996-97. Another aspect of import growth during the current year is that due to (i) a fall in domestic crude oil production, (ii) a sharp rise in domestic demand and (iii) the recent spurt in world oil prices, imports of petroleum products are likely to push up the import bill in a big way.

Exports: Exports were more or less stagnant at around Rs. 600 crore during the fifties. The introduction of some export promotion measures led to the rise of exports in the sixties. Significant rise was seen in the exports of gems and jewellery, readymade garments and engineering goods. After the devaluation of 1966, exports of iron ore, leather and leather manufactures, chemical and allied products, etc. received a further boost. During 1960-61—1969-70, exports grew, on an average, by 10.2 percent.

It was in the 1970s, however, that exports grew significantly. On an average, exports grew by more than 19 percent during 1970/71-1979/80. A sizeable contribution, again came from gems and jewellery, readymade garments, engineering goods, chemicals, leather products, etc.

The high growth rate of India’s exports in the 70s were mainly due to:

- the increase in the unit value index of exports
- the increase in the quantum index of exports
- new markets for India’s exports in oil producing countries with the boom in oil prices
- increase in the price competitiveness of Indian exports as a result of a rise in the world prices of all commodities
- boom in the value of agro-based exports such as oil cakes, marine products and sugar; and
- increase in project exports to the Middle East countries.

During the 80s, particularly in the early 80s, the growth of exports slowed down. Exports grew by about 11 percent in the first half of eighties but the growth picked up later and exports grew by almost 27 percent in the second half of eighties. The sluggishness in export growth in the early eighties was mainly due to decline in demand for Indian exports abroad – adoption of protective measures by developed countries – fall in the value of the US dollar, among others.

The reorientation of the industrial and trade policy regime in the 1980s to release the supply side constraints was combined later in the decade with a more activist policy on the exchange rate so as to attain a steady depreciation in the real effective exchange rate. The improvement in productivity performance and the loosening of the tight import control regime created a better environment for exports. New incentives for exports, notably the exemption from tax of profits on export operations, also encouraged export growth. As a result, the growth of exports went up, both in terms of value and volume.

In 1990-91, export growth once again declined but only marginally to about 18 percent. This deceleration in exports was attributed to:

(1) A slow down in the expansion of world trade. The volume of world trade decelerated from 7.3 percent in 1989 to 4.2 percent in 1990 and further to 0.9 percent in 1991.

(2) Loss of export markets in the Middle East due to the Gulf crisis.

(3) Political and economic upheavals in Eastern Europe, which earlier provided a sheltered market to Indian exports.

(4) Import curbs introduced during 1990-91 in response to foreign exchange shortage and intensified after the Gulf crisis, affecting export-related imports.

(5) Movement in the exchange rate which was broadly supportive of exports since 1986-87 becoming adverse thus affecting competitiveness of exports; and

(6) Internal law and order problems in some states.

The currency devaluation in 1991 and the subsequent liberalisation of export-import regime particularly full convertibility of rupee on current account have given a boost to the growth of exports. As a result, exports grew more significantly during the early '90s as compared to the earlier decades (Table 13.2).

Table 13.2: Growth of Exports: 1960-61—2001-02

Year	Growth Rate (%)
1960-61 to 1969-70	10.2
1970-71 to 1979-80	19.3
1980-81 to 1989-90	14.9
1990-91	17.6
1991-92	35.3
1992-93	21.9
1993-94	30.4
1994-95	18.4
1995-96	29.3
1996-97	11.7
1997-98	9.5
1998-99	7.4
1999-00	14.2
2000-01	27.6
2001-02	2.7

Source: 1. *India: Towards Globalization*, UNIDO, 1995.
2. *Economic & Political weekly,* September 28, 1996.
3. *Economic Survey*, 2002-03.

However, the trends in foreign trade in April-August in 1996-97 have been discouraging as exports have only increased modestly. This was mainly due to a shartp fall in exports in July 1996 (2.66 percent) and in August 1996 (2.3 percent). During April-June 1996, exports grew at 26.7 percent which is quite comparable to the performances of the previous years. The rising cost of production, bottlenecks in ports and heavy rain in some regions are stated to be the factors responsible for the drop in export earnings in the months of July and August. With the easing of the latter two factors, export growth is likely to increase in the subsequent months.

Thus, India's exports have grown considerably both in terms of value and volume, over a period of time. However, a significant indicator of India's export performance is India's share in world exports. Despite the significant growth, India's share in world exports was negligible and the relative share remained more or less at the same level (Table 13.3). This is attributed to India's failure in improving its competitiveness in terms of price and quality in the international market.

Table 13.3: India's Share in World Exports

	Exports in US $ Million		India's share in World Exports
Year	World	India	(%)
1970	313706	2026	0.6
1975	875500	4355	0.5
1980	1989867	8378	0.4
1985	1932387	8750	0.5
1990	3137485	18178	0.6
1992	3218905	18145	0.6
1995	4946096	31117	0.6
1998	5091105	32700	0.6
1999	5522372	32639	0.6

Source: *Economic Survey,* 1995-96 & 2002-03.

13.3 INDIA'S FOREIGN TRADE : COMPOSITION

The composition of foreign trade refers to the kinds of goods imported and exported by a country. It is essential to understand the composition of imports and exports as it reveals the economic status of a country. The changes that may occur in the composition of trade over a period of time reflect the economic transformation of a country.

In general, a developing country's imports comprise mainly heavy manufacturing goods like machinery, transport equipments, iron and steel, etc. whereas exports comprise mainly primary commodities like agricultural products, natural resources such as iron ore, and light manufactures consisting of textiles, leather products, processed foods etc. But in the process of industrialisation and economic development, the composition of trade undergoes a transformation. As a consequence, a developed country's imports would include mostly primary commodities and light manufactures and exports would consist mainly of heavy manufactured goods.

Imports: At the beginning of the 1950s, India's imports consisted mainly of food grains, machinery, transport equipment, iron and steel, petroleum and petroleum products, etc.

The announcement of the Industrial Policy Resolution, 1956 and the subsequent emphasis on the development of heavy and basic industries in the second five year plan had an impact on import composition. The policy of import substitution necessitated the setting up of a wide variety of industries to produce various manufactured goods such as machine-tools, sugar mill machinery, cement machinery, railway wagons, commercial vehicles, automobile tyres and tubes, etc. All these led to an increase in the import of capital goods and equipments in the late fifties.

The relatively underdeveloped agriculture and the demand–supply gap for good grains caused the import of food items, particularly cereals and cereal preparations. Food items accounted for about 15 percent of the Import bill in 1950-51. Since then food imports ranged between 15 percent and 17 percent for almost two decades. However, since the eighties, the relative share of food imports has declined considerably. This largely reflects the near self-sufficiency in food grains attained by India over the period.

A significant portion of India's imports comprised raw materials and intermediates (Table 13.4). These accounted for Rs. 527 crore out of the total imports of Rs. 1122 crore in 1960-61, thereby accounting for 47 percent of the value of imports. In 1970-71, raw materials and intermediates accounted for more than 50 percent of the value of imports. In 1980-81, their relative share peaked to about 78 percent. This was largely due to a rise in the quantum and prices of petroleum products. In 1985-86, the share of raw materials and intermediates relatively declined to 71 percent.

Table 13.4: Structure of India's Imports : 1960-61 — 2001-02
(% Share in value)

Major Items		1960-61	1970-71	1980-81	1990-91	1994-95	2000-01	2001-02
I	Food and related items	19.0	14.8	3.0	N.A.	N.A.	3.7	4.5
II	Raw materials and Intermediate Manufactures of which:	47.0	54.4	77.8	N.A.	N.A.	N.A.	N.A.
a:	Petroleum, oil and lubricants (POL)	6.1	8.3	41.9	25.0	20.7	31.0	27.2
b:	Fertilisers and chemical products	7.8	13.2	11.9	N.A.	N.A.	8.2	8.9
c:	Pearls, precious and semi-precious stones	0.1	1.5	3.3	8.7	5.7	9.6	9.0
d:	Iron and steel	11.0	9.0	6.8	4.9	4.1	1.4	1.5
e:	Non-ferrous Metals	4.2	7.3	3.8	2.6	3.3	1.1	1.3
III	Capital Goods	31.7	24.7	15.2	24.2	22.2	11.0	11.4
IV	Other items (unclassified)	2.3	6.1	4.0	N.A.	N.A.	20.1	22.2
	Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: *Economic Survey*, 1995-96 & 2002-03.

Of the raw materials and intermediates, (i) Petroleum, oil and lubricants (P.O.L) (ii) Fertilisers and chemical products (iii) Pearls, precious and semi-precious stones (iv) Iron and steel (v) Non-ferrous metals are the major items of imports. The very composition of raw material and intermediate imports has undergone a change since the fifties. In 1960-61, iron and steel and non-ferrous metals formed a significant part of the value of imports. However, their importance has declined steadily and gradually since then. POL formed about 1/8 of the value of imports in 1960-61. But their relative share has risen considerably both due to a consistent rise in the quantum imported and in the prices of petroleum products in the international market.

Since the late ’80s, POL imports account for about quarter of the import bill of the country. The recent liberalisation measures introduced with respect to the automobile industry in the country will further push up the domestic demand for petroleum products. The scope for increased domestic production being limited, increased quantum of P.O.L. imports will become indispensable. As a result, the relative share of P.O.L. imports might go up further in the coming years.

The process of agricultural development necessitated a gradual increase in fertiliser imports. Chemical imports comprised mainly of chemical elements and compounds.

The import of pearls, precious and semi-precious stones is done mainly as a raw material for the gems and jewellery industry, which was/is a significant export item of India.

The capital goods imports comprise electrical and non-electrical machinery and transport equipments. The growing industrialisation has only led to increased demand for capital goods of various kinds. The policy of import substitution had little impact on the growth of capital goods imports. In fact, the industrial liberalisation of the nineties, has further pushed up these imports in the first half of nineties. However, there is a remarkable fall in the capital goods imports during April-June, 1996 which is attributed to a likely slow down in the industrial growth of the country. On an average, capital goods have been accounting for about a quarter of the value of imports. Unless and until, India develops its own technology base, its capital goods import requirements will only go up in the future. Thus, P.O.L and capital goods, which together form about a half of the total imports would determine the future growth of India’s imports.

Rise in non-POL imports in 2001-02 was contributed by higher imports of food & related items (mainly pulses, edible oil and spices), capital goods imports and imports of other intermediate goods. Imports under the fuel group, fertilizers and paper board, manufactures & newsprint, however, contracted in 2001-02. A significant feature of the performance in 2001-02 was the reversal in trend in imports of capital goods, which increased by 6.3 percent as against substantial declines in the preceding two years. Another highlight was the turnaround in export related imports that increased by 1.6 percent in 2001-02 as against a decline of 10.9 percent in 2000-01.

Exports: The structure of India’s exports has undergone a considerable change since independence. Exports started growing considerably only since the sixties. India’s exports are broadly classified under:

(i) agriculture and allied items which includes coffee, tea, oil cakes, tobacco, cashew kernels, spices, sugar, raw cotton, rice, fruits and vegetables, etc.

(ii) ores and minerals which include mica and iron ore, among others,

(iii) manufactured goods consisting of gems and jewellery, ready made garments, engineering goods, chemicals, leather products, jute manufactures, etc.

(iv) mineral fuels and lubricants (including coal); and

(v) others.

The major value of India’s exports emanated from agricultural products on the one hand, and manufactured goods on the other (Table 13.5). Among the agricultural items, *tea was a prominent foreign exchange earner for the country.* In 1960-61, tea exports earned about Rs. 124 crore out of the total exports revenue of Rs. 643 crore (thereby it accounted for about 20 percent of

the total value of exports). However, the relative contribution of tea exports to total exports has come down gradually. In 1990-91, tea export contribution to total exports amounted to only 3.3 percent. Some of the major agricultural items whose exports have increased over the period, are cashew kernels, spices, rice, fish and fish preparation, tobacco, oil cakes and more recently, fruits and vegetables.

Though the export value of agriculture and allied products has consistently increased since the ’60s, their relative share in the total value of exports declined steadily. This could be broadly attributed to two factors:

- Despite agricultural development (which has been confined to certain regions within the country) commercialisation of agriculture has not taken place on a significant scale. Subsistence farming, which largely, prevails in India constrains the scope for export growth.
- Exports from the manufacturing sector have grown more significantly.

However, in the ’90s agricultural development has been gaining increased attention from the policy markers:

1. The Government of India has brought out an Agricultural Policy which lays more thrust on agricultural development and exports.
2. The food processing industry has been accorded a ‘sun rise industry’ status for its promotion, in order to prevent the wastage of fruits and vegetables due to lack of processing facilities and to promote exports of processed foods.
3. The export obligation of Export Oriented Units (EOUs) related to agriculture and allied products has been brought down to 50 percent. This enables these EOUs to sell the remaining 50 percent of the production in the domestic market thereby enabling them to settle down quickly.
4. Some of the state governments have taken policy decisions to enable food processing units to acquire agricultural land for cultivating the required raw materials for in house consumption.
5. Even ‘contract farming’ is encouraged to promote agriculture industry linkages.

All these are aimed at giving a new turn to agriculture development and exports in the nineties. However, the relative share of agriculture and allied items in total exports has declined further in the nineties. If the potential of Indian agriculture is harnessed appropriately, agriculture and allied items exports could be stepped up more significantly in the future.

The exports of manufactured goods have grown at a much faster rate than that of agriculture. As a result, the relative share of manufactured goods in the total value of exports has gone up steadily from 45 percent in 1960-61 to 78 percent in 1994-95. This reflects a positive outcome of India’s industrial development.

Even within manufacturing exports, the composition has changed over the period. In 1960-61, jute manufactures was the most prominent manufactured item of exports (by contributing more than 46 percent of the total value of manufactured exports which amounted to 21 percent of the total value of exports). However, with the emergence of substitutes for jute goods in the international market and the decline of jute industry domestically, the share of jute goods in the total value of exports decreased continuously. In 1990-91, jute manufactures’ exports accounted for hardly 1 percent of the total value of exports and in 1994-95 it declined further to 0.6 percent.

Table 13.5: Structure of India's Imports : 1960-61 – 2001-02
(% Share in value)

Major Items		1960-61	1970-71	1980-81	1990-91	1994-95	2000-01	2001-02
I	Agriculture and allied products	44.2	31.7	30.7	19.4	16.6	13.5	13.4
II	Ores and Minerals	8.0	10.7	6.2	4.6	3.1	2.6	2.9
III	Manufactured Goods	45.3	50.3	55.8	72.9	78.2	78.0	76.1
	– Gems & Jewellary	0.1	2.8	9.6	16.1	17.1	16.6	16.7
	– Readymades	0.1	1.9	8.4	12.3	12.5	12.5	11.4
	– Engineering Goods	2.0	12.0	13.0	11.9	13.2	—	—
	– Chemicals	1.1	2.3	3.5	6.5	9.2	—	—
	– Leather Products	3.0	4.7	5.0	8.0	6.1	3.8	3.7
	– Jute manufactures	21.0	12.3	4.9	0.9	0.6	—	—
	– Other manufactures	21.0	14.2	11.3	17.2	—	—	—
IV	Minerals/Fuels and Lubricants	1.1	0.8	0.4	2.9	2.0	2.6	2.9
V	Others	1.4	6.5	6.9	0.2	0.1	1.7	2.8
	Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: *Economic Survey,* 1995-96 & 2002-03.

The export of (1) readymade garments, (2) leather and leather products (3) gems and jewellery (4) engineering goods and (5) chemicals has increased gradually. In 1994-95, these five items together had a share of more than 58 percent of the total value of exports. In 1960-61, these same items contributed hardly 8 percent of the total value of exports.

The decline in value of exports in 2001-02 was spread across both the agricultural and manufactured commodity groups. Under manufactured goods, major exports like gems & jewellery, engineering goods, textiles including readymade garments, chemical & related products, leather & manufactures recorded sharp decelerations or even decline in exports. The decline in agricultural and allied exports (including plantation) in 2001-02 was mainly on account of lower exports of tobacco, marine products, spices and cashew nuts. While the decline in exports of tobacco and cashew nuts was due to lower volume of these exports, decline in unit value contributed to lower exports of spices and marine products.

The share, in total exports, of manufactured goods and agriculture and allied products declined from 78.0 percent and 13.5 percent respectively in 2000-01 to 76.1 percent and 13.4 percent respectively in 2001-02. Correspondingly, share of exports of petroleum products and ores and minerals, in total exports, increased to 4.8 percent and 2.9 percent respectively during the year.

This brings out the fact that the export composition of India has grown more in terms of non-traditional items than traditional items. But non-traditional items are largely confined to *light manufactures.* The share of only light manufactures went up from year to year. Thus, though the export composition got diversified in terms of faster growth of non-traditional items, these are

largely confined to light manufactures. The near absence of *heavy manufactures* in India's exports reflects the inadequate indigenous technology base for the development of heavy manufactured goods. Unlike industrialising countries like South Korea and Singapore, India's export composition has not yet started diversifying in the form of significant emergence of heavy manufactured goods and consumer durables.

Activity 1

Prepare a chart describing the major stages in the transformation of India's export and import compositions during the planning period.

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13.4 INDIA'S FOREIGN TRADE : DIRECTION

India's foreign trade relations cover the countries all around the world. To understand the reigonal direction of India's foreign trade and its progress, countries of the world are classified under five broad groups :

I. Organisation for Economic Co-operation & Development (OECD) Countries which, in turn, comprise:

   (1) The European Economic Community (EEC) :
   United Kingdom, Germany, France, Belgium, etc.

   (2) North America : Canada, USA

   (3) Asia and Oceania : Australia, Japan

II. Organisation of Petroleum Exporting Countries (OPEC)

III. Eastern Europe

IV. Developing Countries

V. Others

Imports: Most of India's imports originate from the industrialised (OECD) countries (Table 13.6). In 1960-61, about four-fifths of the imports were from the OECD countries. Of these, the UK and the USA together accounted for as much as 50 percent of the total value of India's imports. However, since then, the relative importance of OECD countries in India's imports has declined to some extent (thought it has increased marginally in the '90s). This is reflected in the gradual fall in the share of UK and USA in the value of India imports. In 1993-94, UK and USA together accounted for hardly 19 percent of the total value of imports. But countries like Belgium and Japan have become more important trading partners as far as India's imports are concerned. By and large, India imports capital goods, raw materials and intermediates from OECD countries.

India imports mainly petroleum, oil and Lubricants (P.O.L) from the OPEC. Both in terms of value and volume, POL had a minor presence in India's import structure in the 60s and 70s. OPEC accounted for hardly 5 percent of the value of imports in 1960-61 and hardly 8 percent in 1970-71. But thereafter, due to the sharp rise in oil prices as well as increase in the quantity of India's imports, the share of OPEC in the value of India's imports went up steeply. As a result, imports in 1980-81 from OPEC accounted for almost 28 percent of the import bill. The subsequent fall in international oil prices resulted in a relative fall but went up again as a result for the Gulf crisis in 1991.

Table 13.6: Direction of India's Imports 1960-61 – 2001-02
(% Share in value)

Countries	1960-61	1970-71	1980-81	1990-91	1995-96	1999-00	2000-01	2001-02
I OECD :	78.0	63.7	45.7	54.0	52.4	43.0	39.9	40.1
1. EEC :	37.1	19.6	21.0	29.4	26.7	21.2	19.8	19.1
– Belgium	1.4	0.7	2.4	6.3	4.6	7.4	5.7	5.4
– East Germany	10.9	6.6	5.5	8.0	8.6	3.7	3.5	3.9
– UK	19.4	7.8	5.8	6.7	5.2	5.5	6.3	5.0
2. North America	31.0	34.9	14.7	13.4	11.6	7.9	6.8	7.2
– USA	29.2	27.7	12.9	12.1	10.5	7.2	6.0	6.1
3. Asia & Oceania	7.1	7.4	7.4	11.2	9.7	7.5	5.9	6.9
– Japan	5.4	5.1	6.0	7.5	6.7	5.1	3.6	4.2
II OPEC :	4.6	7.7	27.8	16.3	20.9	22.5	5.4	5.8
III Eastern Europe	3.4	13.5	10.3	7.8	3.4	1.6	1.3	1.4
– USSR	1.4	6.5	8.1	5.9	2.3	1.3	1.0	1.0
IV Developing Countries	11.7	14.6	15.7	18.4	18.3	20.7	17.5	19.1
– Asia	5.7	3.3	11.4	14.0	14.4	15.7	14.4	15.3
V Others	2.2	0.5	0.5	3.5	5.0	12.2	35.9	33.6
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: 1. *India: Towards Globalisation,* UNIDO, 1995.
2. *Economic Survey,* 2002-03.

The growing domestic demand for P.O.L and increasing oil prices in the international market will make OPEC all the more important in terms of India's imports in the future.

Eastern Europe, particularly, the former USSR was a significant source of India's imports for nearly two decades: mid-sixties to mid-eighties. The main items of imports from these countries were iron and steel, non-ferrous metals, chemicals, capital equipment, pharmaceuticals and petroleum products. However, with the transformation of the economic system of East-European countries and the disintegration of the USSR, imports from Eastern Europe declined drastically.

The regional shares in sourcing of imports in 2001-02 reveal enhanced shares from all the major regions, with a corresponding reduction in share of residual category. This was contributed by an increase in imports from OECD, OPEC Eastern Europe and from other developing countries.

A significant development in the direction of India's imports is with reference to developing countries, particularly Asia. The imports generated from Asian countries have increased significantly since the '80s. This could be attributed to (i) rapid economic development of many Asian countries, specially South East

Asian-countries and (ii) greater trade co-operation among the members of SAARC (South Asian Association for Regional Co-operation).

On the whole, India has experienced increasing regional diversification in the process of the growth of imports.

Exports : A major share of India's exports goes to industrialised (OECD) countries (Table 13.7). In 1960-61, more than 66 percent of the value of exports were absorbed by OECD countries. But the relative share of OECD countries in India's exports declined in 1970-71 and again in 1980-81. Thereafter, the share has increased again. In the '90s, the exports to OECD countries stood at around 57 percent. Within the OECD countries, UK and USA were the major destinations for India's exports, which accounted for as much as 43 percent of the value of exports in 1960-61. However, the pre-eminent position of these two countries, particularly the UK has declined considerably since then. Of course, in the nineties, the USA is emerging as a major trade partner in terms of India's export destination. In 1990-91, exports to the USA accounted for almost 15 percent of the value of exports.

Table 13.7: Direction of India's Imports 1960-61 – 2001-02
(% Share in value)

Countries	1960-61	1970-71	1980-81	1990-91	1995-96	1999-00	2000-01	2001-02
I OECD :	66.2	50.1	46.6	53.5	55.7	57.3	52.7	49.3
1. EEC :	36.2	18.4	21.6	27.5	26.5	24.7	22.7	21.8
– Belgium	0.8	1.3	2.2	3.9	3.5	3.7	3.3	3.2
– Germany	3.1	2.1	5.7	7.8	6.2	4.7	4.3	4.1
– UK	26.9	11.1	5.9	6.5	6.3	5.5	5.2	4.9
2. North America	18.7	15.2	12.0	15.6	18.3	24.4	22.4	20.8
– USA	16.0	13.5	11.1	14.7	17.4	22.8	20.9	19.4
3. Asia & Oceania	10.1	15.2	10.6	10.4	8.3	5.8	5.1	4.5
– Japan	5.5	13.3	8.9	9.3	7.0	4.6	4.0	3.4
II OPEC :	4.0	6.4	11.1	5.6	9.7	10.6	10.9	12.0
III Eastern Europe	7.0	21.0	22.1	17.9	3.8	3.1	2.4	2.3
– USSR	4.5	13.7	18.3	16.1	3.3	2.6	2.0	1.8
IV Developing Countries	14.8	19.9	19.2	16.8	25.7	25.6	26.7	28.0
– Asia	7.0	10.8	13.4	14.3	21.3	20.9	21.4	22.4
V Others	8.0	2.6	1.0	6.2	5.1	3.4	7.3	8.4
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: 1. *India: Towards Globalisation,* UNIDO, 1995.
2. *Economic Survey,* 2002-03.

Today, India's exports within OECD are not confined to only UK and USA but more evenly spread among other countries such as Belgium, France, Germany, Japan, the Netherlands, etc. This implies that India's export penetration has been diversified among the OECD countries over the period.

The share of OPEC in India's exports has always been minimum and showed no definite trends over time.

India's export trade with Eastern Europe like that of imports peaked during the '70s and '80s. But since then, due to the factors described earlier, exports to the region have declined rapidly.

Direction of exports over the 1990s show greater consistency in our exports to Organisation for Economic Cooperation and Development (OECD) countries, including the European Union (EU) region and larger fluctuations/dispersal to areas like the Organisation of Petroleum Exporting Countires (OPEC), Eastern Europe and other developing countries. In 2001-02, exports to OECD countries declined due mainly to lower exports to major countries like USA, Japan, Canada, U.K., Germany, France and Belgium. Decline in exports to Eastern Europe was due to lower exports to Russia. The rise in exports to OPEC region was mostly contributed by higher exports to Nigeria, Indonesia and Iraq. Overall, while the OECD countries' and Eastern Europe region share in total exports declined to 49.3 percent and 2.3 percent respectively, the shares, in total exports, increased to 12.0 percent for OPEC region and 28.0 percent for other developing countries in 2001-02.

A significant development in the direction of India's exports, is the emergence of Asian Countries as the major buyers. Since 1960-61, the share of Asian Countries in India's exports has steadily gone up. The growing economic prosperity in South East Asia and greater trade Co-operation among Asian Countries, particularly South Asian countries, may have contributed largely to this development.

The destination of India's exports and imports has some important implications:

- Despite relative decline in importance, OECD countries are the major destination for Indian exports and major source of imports.
- Among the OECD countries, the USA has emerged as the leading trade partner of India.
- The importance of developing countries, particularly Asian countries as trade partners is growing gradually.
- The trade relations with East European countries including Russia have declined drastically since 1990-91.
- Due to P.O.L. imports, the OPEC is an indispensable trade partner but its importance in terms of trade exports is not too significant.
- India's trade relations with South American and African countries are negligible.

Activity 2

Develop a bar diagram for India's trade balance on the basis of data provided in Table 13.1. Analyse the factors for its fluctuations.

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13.5 SUMMARY

India's foreign trade has grown remarkably, both in terms of value and quantity, since the beginning of economic planning. The policy of industrial and trade liberalisation introduced in 1991 has given a new turn to the growth of both imports and exports. However, imports have always exceeded exports which means that India has become a perennially trade deficit country.

India's imports mainly comprise capital goods like machinery and equipments, raw materials and intermediates like P.O.L., iron and steel, non-ferrous metals, precious stones, etc. Thus, India's imports are crucial in nature for the functioning of the economy. India's export composition has transformed with the faster growth of manufactured goods and the relative decline of agricultural and allied products. But, manufactured exports are largely confined to light manufactures. India's imports as well as exports have also undergone diversification in terms of destination.

As a result of all these, the share of foreign trade in India's Gross National Product (GNP) has been increasing steadily. But it is still lower than that of East Asian and Latin American countries. The share of foreign trade in GNP in India accounted for 17 percent in 1992 whereas it was 54 percent in South Korea, 36 percent in China and 23 percent in Mexico. Further, the share of India's exports in world exports has been negligible which is the outcome of the lack of competitiveness of Indian goods in the international market. All these show clearly that, despite remarkable growth, India has to go a long way in:

- attaining economic self-sufficiency in the form of paying for imports through exports
- improving the competitiveness of its goods in terms of price and quality to increasingly penetrate the world market
- diversification of exports, specially in terms of heavy manufactures
- realising foreign trade as a major sector of the economy in terms of GNP.

13.6 KEY WORDS

(i) **Import Substitution** The process of developing industries to produce those goods which are currently imported with the objective to acquire indigenous capability to produce imported goods and curtail imports.

(ii) **Balance of Trade** (or trade balance) Refers to the difference between the values of exports and imports. If the value of exports is more than the value of imports, the trade balance is said to be positive or favourable. If the value of imports is more than the value of exports, the trade balance is said to be unfavourable or negative.

(iii) **Negative List** Refers to list of items whose imports are totally banned.

13.7 SELF ASSESSMENT QUESTIONS

1. Write an essay on why a developing country should engage in foreign trade.
2. Discuss the role and significance of foreign trade for a developing economy.
3. Analyse the major trends in the growth of India's foreign trade.
4. "India's imports are more critical and indispensable than exports." Do you agree? Why?
5. "Exporting minerals and agricultural raw materials in the long run may prove counter-productive for the economic development of a country." Do you agree with the statement? Give reasons to support your argument.
6. "India's export composition has transformed more significantly than its import composition over the period." Is it true? Why?
7. "The direction of India's exports and the origin of India's imports have followed a similar pattern in terms of regional diversification". Critically evaluate.
8. Analyse the major implications and shortcomings of India's foreign trade growth since Independence.

13.8 FURTHER READINGS

1. UNIDO, 1995: *India: Towards Globalisation.*
2. Government of India: *Economic Survey,* Ministry of Finance, 1990-91, 1991-92, 1992-93, 1993-94, 1994-95, 1995-96, 2002-03.
3. Ministry of Commerce: *Annual Reports.*
4. Reserve Bank of India: *Annual Reports.*

UNIT 14 BALANCE OF PAYMENTS AND EXIM POLICY

Structure

14.0 OBJECTIVES

After studying this unit. you should be able la:

- distinguish between balance of trade and balance of payments
- make distinction between current account and capital account
- explain the concept of balance of payments and its significance
- explain the concept of rate of exchange
- describe the mechanism of exchange rate determination
- evaluate the current Export-Import policy of the Government
- elaborate the role of the EXIM Bank in India's foreign trade.

14.1 INTRODUCTION

In the previous unit we have studied the changing structure of India's foreign trade since independence. Trade is only one aspect of international economic transactions. A constant flow of men. material and capital takes place between nations

This flow involves both payments and receipts of foreign exchange. A nation needs to keep a systematic record of these transactions. It is only then that an economy's dependence on the rest-of-the-world and its capability to utilise external resources for its own development gets determined. This systematic record of transactions is called balance of payments.

'14.2 CONCEPTS OF BALANCE OF TRADE (BOT) AND BALANCE OF PAYMENTS (BOP)

The principal tool for the analysis of the monetary aspects of international trade is the **balance of international payments settlement.** This statement is also simply known as the balance of payments **(BOP). BOP is a systematic record of all international economic transactions, visible and invisible of a country during a given period, usually a year.** In other words, the BOP statement is a device for recording all the economic transactions within a given period between the residents of a country and the residents of other countries.

14.2.1 Current Account and Capital Account

The analysis of the BOP can be done in terms of its two major sub-divisions, viz., 1) Current Account, and 2) Capital Account

1. **Current Account:** The current account of the BOP can be divided in two parts, viz., a) balance of trade and. b) balance of trade in services.

   a) **Balance of Trade (ROT): The BOT** deals only with exports and imports of merchandise (or visible items). The net balance in the BOT will show the monetary value of the difference in exports (x) and imports (M) of a country. Thus, three types of net BOT can he vasualised: i) Deficits in BOT; these will occur when X < M; ii) Surplus in BOT; these will occur when X > M; and iii) Balance in BOT; these will occur when X = M.

   b) **Balance of Trade in Services (BOS):** The BOS shows net receipts on account of trade in services, (or what are also called invisibles). We can broadly classify invisibles into five groups, viz., i) services, such as banking, insurance, shipping, civil aviation, royalty, consultancy services, postal services, etc.. ii) investment income, which includes profits and dividends on direct, portfolio and other investments as well as interest charges on bilateral and multilateral loans, iii) travel both business and tourist., iv) government transfers, and v) private transfers. All of these transactions are two-way transactions; i.e. during any year these services would be provided by Indians to the rest-of-the world, and foreigners would be providing these services to India. Indians would receive rewards for their services which are called current receipts (R). Likewise, India would have to pay for the services rendered to it by the rest-of- he-world. These are known as Current Payments (P). The net of current receipts and current payments constitutes balance of trade in services or BOS. During a year BOS may take my of the following three forms: i) Deficits in BOS; these will occur when R<P; ii) Surplus in BOS; these will occur when R>P; and iii) Balance in BOS; these will occur when R = P.

Balance on current account is the sum or aggregate of BOT and BOS, i.e.. balance on current account = BOT + BOS.

Balance on current account is the net of all current foreign exchange earnings of a country during a year and its liabilities in the form of foreign exchange expenditure during the year. Its foreign exchange earnings come out of the exports of merchandise and the receipts arising out of the services rendered by it. Its foreign exchange expenditure is incurred on its imports of goods and the payments due to foreigners on account of the services rendered by them.

The current account of the balance of payments is said to be in surplus when a country has earned more foreign exchange during a year than what it has contracted to spend. In this situation, the country's foreign exchange reserves may increase. Alternatively, it may

decide to pay off its earlier debt with the help of the surplus foreign exchange it has earned during the year. A third alternative may be that it may decide to give loans to other countries out of its own surplus earnings.

Likewise, the current account of balance of payments is said to be in deficit when a country has committed to spend a larger amount of foreign exchange than what it has earned during the year. There may be two alternatives before it now. One, it may draw upon its foreign exchange reserves, and thus settle its liabilities. Two, it may borrow abroad to settle its current liabilities; but in this case it is creating future liabilities for itself in the form of external debt.

If the current account is in balance, i.e., if a country's foreign exchange earnings during a year balance its foreign exchange expenditure, there is nothing much a country has to do in this area.

2. **Capital Account:** The other component of the BOP statement of a country is the capital account. **The capital account of the BOP presents transfer of money and other capital items and changes in the country's foreign assets and liabilities resulting from the transactions in the current account.**

   As said earlier if a country is having a deficit on its current account of BOP it needs to borrow from the rest of the world to square off its current excess liabilities. Likewise, if it has a surplus, it can lend to the rest of the world. These transactions are recorded on its capital account. All the borrowings of a country constitute the credits in the capital account, while all lendings by it constitute its debits in the capital account. Likewise, all repayments of old debts constitute debits, while receipts from the rest of the world constitute its credits. Thus, if a country has been borrowing over a long period of time, during a particular year it would be contracting new loans as well as paying off earlier debts. The net of these debits and credits constitutes the capital account of the BOP.

   It would be observed that the capital account transactions are designed to provide the balance for current account deficits (or surpluses). It means that if a country is having current borrowing, it is left with a sufficient surplus to meet its current excess liabilities, after meeting its repayment obligations of the past debt that fall due in the year. Apparently, a country will be obliged to borrow more if either its current account deficit is high or its commitments towards repayment of debt are high or both.

   In any case, if a country has a deficit on its current account of BOP it will need to have a surplus on its capital account BOP; the surplus on capital account will be used to finance the deficit on current account.

14.2.2 Balance of Payments

The term 'balance of payments' is the sum or aggregate of its current account and capital account. Current account and capital account will always move in the opposite directions; a deficit on current account will always meet with a matching surplus on capital account, and conversely a surplus on current account will match with a deficit on capital account. In the ultimate analysis, an economy's BOP will be in balance i.e., there will be no deficits and surpluses in aggregate BOP.

The above equality in the two sides of the BOP account is of course only an accounting equality. It would be observed that if a country continuously incurs current account deficits and finances such deficits with capital account surpluses, all that it is doing is that it is postponing its current liabilities to the future. The external debt burden will keep on increasing as new debt is further contracted.

The BOP accounts provided a link between the increase in gross external debt and the imports and spending decisions of the economy. Thus,

Increase in gross external debt = Current account deficit—direct and long-term portfolio capital inflows + official reserve increases + other private capital outflow.

From the above relationship it would be clear that in the process of economic development a small deficit on current account is required to take advantage of the foreign savings and build up physical investments domestically.

Check Your Progress A

1. What is balance of payments?

2. Distinguish between visible items and invisible items of trade. Give three examples of each.

3. Distinguish between balance of trade and balance of payments.

4. When will a country need to have a surplus on its capital account?

14.3 TRENDS IN INDIA'S BALANCE OF PAYMENTS

India has faced pressures on BOP from time to time either due to certain domestic compulsions or due to external factors. The whole period, covering nearly the four and a half decades can be divided into four sub-periods depending on i) the nature of BOP problem, ii) the over all macro economic environment, and iii) the external aid situation. The four sub-periods are as follows: 1) period I (up to 1975-76), 2) period II (1976-77 to 1979-80), 3) period III (1980-81 to 1989-90), 4) period IV (1990-91 onwards).

1. **Period I (up to 1975-76):** The entire period was very difficult for India's BOP, partly because of slow growth of exports in relation to import requirements and partly because of adverse external factors. Despite tight import controls (through quantitative restrictions) and foreign exchange regulations, the current account deficit was 1.8 per cent of the GDP. Foreign exchange reserves were at low levels, generally less than necessary to cover three months imports. Almost the entire current account deficit (92 per cent) was financed by inflows of external assistance on highly concessional terms. There was hardly any commercial deficit.

2. **Period II (1976-77 to 1979-80):** These few years stand out as the golden years for India's BOP. India had a small current account surplus (0.6 per cent of the GDP on an average) and foreign exchange reserves equivalent to about seven months' imports. Export growth was good but the primary reason for the sharp improvement in BOP was the dramatic improvement in net invisibles. Net invisibles increased from Rs. 193 crores in 1974-75 to Rs. 2,486 crores in 1979-80.

3. **Period III (1980-81 to 1989-90) :** The period broadly corresponds to the period of the sixth Plan and the Seventh Plan. The Sixth Plan was launched when the economy was Paced with severe BOP difficulties. In 1981, India entered into an arrangement with the International Monetary Fund for a loan of SDR 5. billion under the Extended Fund Facility. The amount was to be disbursed over a period of three years.

   India, however, drew only SDR 3.9 billion and the arrangement was terminated in early 1984 at India's request because of the improvement in the BOP position in 1983-84. The BOP deficits were particularly acute during the Seventh Plan period. The current account deficit during the whole plan period was as high as 2.2 per cent of the GDP as against 1.3 per cent of the GDP during the Sixth Plan period.

4. **Period IV (1990-91 onwards):** The BOP crisis reached its climax during 1990-91; current account deficits reached a maximum of 3.26, per cent of the GDP, as would be seen from Table 14.1 below.

Table 14.1 : Key Indicators of India's Balance of Payments

(**As** per cent of GDP)

Year (a)	**Exports** (b)	**Imports** (c)	**Trade Balance** (d) {(b)-(c)}	**Net Invisibles** (e)	**Current N C deficit** {(d)+(e)}
Average of					
1985-90	5.1	8.3	-3.2	0.9	-2.3
1990-91	6.25	9.43	-3.18	-0.08	-3.26
1991-92	7.30	8.15	-0.85	0.01	-0.84
1992-93	7.60	9.00	-1.40	-0.10	-1.50
1993-94	8.90	9:30	-0.40	0.30	-0.10
1994-95	8.90	10.40	-1.50	0.70	-0.80
1995-96	9.90	12.60	-2.70	1.10	-1.70

India was faced with a serious BOP crisis. In view of this, a comprehensive strategy to deal with it was put in place. Although the BOP continued to be under pressure during 1992-93, there was a distinct improvement compared to the crisis situation prevailing in the middle of 1991. Since then the BOP situation has continued Io regisler improvement, although we have not come out of their shadows coniipletely.

14.4 CAUSES OF BOP DEFICITS

The BOP deficits have come to slay with us for long. We will take an overall view of the causes responsible for these deficits, and would like to identify them more particularly in the light of recent happenings. These causes are:

1. **Balance of trade deficits:** The first and the foremost cause of balance of payments deficit in India has been the trade deficits that India has had to encounter right since the beginning of the growth process. The import needs of the economy went on increasing without a corresponding increase in exports, resulting in mounting trade deficits.

   Even in more recent times there is sufficient evidence to indicate that the import intensity of Indian industry is rising under pressure of global competition, and with search for advanced technology this trend is certain to continue. Thus, there is apprehension that unless it is matched by high export growth there may be some risk of a substantial drain of foreign exchange reserves.

2. **Declining surpluses on account of invisibles:** A marked feature of India's BOP has been that it has been earning a net surplus on account of trade in invisibles. Large earnings on account of invisibles have been due to remittances from Indians working abroad **and** surplus earnings on travel services. In the long run, the net position on invisibles would depend on the outcome of two opposing sets of forces one being the

surplus earnings on travel services, government transfers and private transfers and the other being the deficit on investment income. Interaction of these two sets of opposing forces would not, however, change the trend in the immediate future. Invisible trade would generate surplus for possibility that in the long run the negative forces of investment income would outweigh the positive impact of the rest of the items, leading to a deficit in invisible trade thereby creating further complications in the BOP.

3. **Mounting burden of external debt servicing:** Another factor behind the increasing pressure on the BOP has been steadily mounting burden of external debt servicing. This is estimated to have increased from about $ 7.6 billion in 1989-90 to about $ 10.5 billion in 1994-95. Not only has the total volume of external debt been increasing rapidly, the share of short-term commercial borrowing-at market rates of interest as against concessional Official Development Assistance (ODA) and NRI deposits designated in foreign currencies has been increasing rapidly. With the hardening of interest rates abroad, this newly evolving pattern of external liabilities has steadily pushed up the debt service liability. Indeed, it is the increasing payment of interest on external debt - payment on current account - arising from the increasing total debt liability, which has added to the need for external borrowing.

4. **Dim prospects of getting concessional aid:** During the earlier course of economic development, current account deficits could easily be funded by concessional aid both from bilateral and multilateral sources. But towards the end of eighties the various sources of concessional assistance were drying up, whereas current account deficits were mounting up. The prospects for getting concessional aid on an increasing scale appears to he bleak under the given economic circumstances, mainly because of the following four factors: a) the generally worsening climate for Official Development Assistance (ODA) - most developed nations have been unwilling to increase and, in some cases, even maintain the size of their contribution, as one writer describes it there is growing aid fatigue among foreign donors; b) the view that the Indian econoniy is now equipped to tap commercial sources of foreign exchange finance; c) the entry of new claimants on the pool, such as China and other nations of East Europe, d) and emergence of new independent nations, like Estonia, Lithuania, Latvia, Ukraine, etc.

Since commercial borrowings are a quite costly proposition there is a limit, beyond which it may not he possible for the Government to borrow, Even in case of such loans care must be taken that they should be raised for projects which are carefully selected, speedily executed and which have direct impact on increasing our exports or reducing the magnitude of imports.

Check Your Progress B

1. What has been the most difficult period from the point of view of balance of payments of India?

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2. Mention four important causes of balance of payments difficulties in India?

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3. State whether the following statements are True or False.

   i) India had to face pressures on BOP due to external factors.

   ii) The BOP deficits were particularly acute during the Seventh Plan period.

iii) The import intensity of Indian industry is rising under the pressure of global competition.

iv) The capital account deficits could easily be funded by concessional aid both from bilateral and multilateral sources.

v) India has better prospects for getting concessional aid on an increasing scale.

14.5 MEASURES ADOPTED TO SOLVE THE PROBLEM

From the point of view of the measures adopted hy the government to solve the problem of BOP deficits the whole period since 1950-51 can be divided in two parts, viz., 1) Till 1991 and 2) Since 1991.

1) Till 1991: BOP deficits were sought to be controlled by measures like i) promoting the growth of import-substitution type of industries, ii) putting physical restrictions on imports, iii) extending assistance for export promotion, iv) providing incentives for increasing foreign exchange earnings on account of invisibles. However these measures could only moderately be successful which is brought out clearly by the fact that the country was faced with BOP crisis of unprecedented dimensions.

2) Since 1991: India has put in practice a comprehensive strategy to overcome BOP deficits. The main elements of this strategy can be identified as follows:

i) Fiscal and Monetary Discipline: Strict fiscal and monetary discipline has been sought lo be adopted to control aggregate demand. The central fiscal deficit stands reduced from 8.4 per cent of GDP in 1990-91 to 6.1 per cent in 1991-92, 5.2 per cent in 1992-93, 7.7 per cent in 1993-94, 6.7 per cent in 1994-95, 6.0 per cent in 1995-96 and 5.5 per cent in 1996-97.

Monetary policy has aimed at slowing down the growth of money supply from 18.5 per cent in 1991-92 to 14.2 per cent in 1992-93, 18.2 per cent in 1993-94, 18.7 per cent in 1994-95, and 15.7 per cent in 1995-96.

ii) Exchange Rate Policy and Foreign Trade Policy Reforms: LERMS, a dual exchange rate system was introduced in the Budget for 1992-93; under this system, 40 per cent of foreign exchange earnings were required lo be surrendered at the official exchange rate; remaining 60 per cent were to be converted at a market-determined rate. Union Budget for 1993-94 introduced UERS Which makes rupee convertible at unified market determined rate of exchange. Now, all payments and receipts of foreign exchange are converted in rupees at market rate of exchange. Union Budget for 1994-95 introduced full convertibility on current account that makes many trade transactions relatively free of controls. As a part of foreign trade policy .reforms, import restrictions on capital goods, raw materials and components have been virtually eliminated. Thus, excess import demand will be reflected in a higher market exchange rale and self-correcting mechanism will operate lo keep trade deficit in check. Along with this considerable reductions in peak tariffs, especially tariffs on capital goods, have been affected. Cash margins and interest surcharge on import credit have been abolished. Harmonised system of customs classification has been introduced.

iii) Structural Reforms: Among these we may briefly mention the following: a) substantial deregulation of trade and industry; b) delicensing of many industries; c) promotion of competition by the opening up of many areas, previously reserved for the public sector, to private and foreign investment; d) policies put in place to attract foreign direct and portfolio investment; e) amendment of SICA to permit public enterprises to he examined by BIFR; f) financial sector reforms including deregulation of interest rates, dismantling of direct credit, reforming the banking system, improving the functioning of the capital .market including the government securities market, etc.

iv) Mobilisation of Exceptional Pinancing: Steps have been taken lo mobilise exceptional finance from multilateral agencies and bilateral donors. (Exceptional financing need is defined as the requirement fell over and above the inflows of

official project aid, commercial borrowings, and NRI deposits.) Among other related measures are: stand by arrangement with the IMF, structural adjustment and social safely net loans negotiated with Asian Development Bank, etc.

The present strategy to overcome BOP crisis is all comprehensive and well coordinated. The results of this type of strategy have been quick to appear. The pressures of BOP ha' considerably eased as is brought out by the fact that the foreign exchange reserves, whicl touched a low of US $2,236 million in 1991 have gone up to over US $21,500 million presently (see Table 14.2 below).

Table 14.2: India's Foreign Exchange Reserves

End of March	Amount US $ million	Import cover (no. of months)	Current paymen cover (no. of month
1951	1914	16.8	14.6
1961	390	2.0	1.7
1971	584	2.9	2.2
1981	5850	4.5	4.0
1991	2236	1.0	0.8
1992	5631	3.3	2.3
1993	6434	3.4	2.5
1994	15068	7.6	2.3
1995	20809	8.2	5.9
1996	17000	5.44	3.8
1997	21500	7.00	4.5

It would be seen lhat whereas in 1991 we were left with megre reserves sufficient to covet only one month's imports and 0.8 month's current payments, now we have accumulated reserves that cover about 6 months' imports and 4 months' current payments. This order of reserves is a good cushion and provides big flexibility to policymakers.

To conclude, India has formulated a successful strategy to overcome BOP limitations on growth. But, all the same, it needs to be remembered that a lasting solution to the BOP problem still alludes us Our current account deficits are still large and are once again set to rise. Large current account deficits imply that wc have to take resort to external borrowings, which in turn put further pressure on BOP deficits. A lasting solution to the BOP deficits is to be found only in generation of large current account surpluses. Generation of current account surpluses, at the present stage of economic development, hy and large, means that we should go in a big way to expand our exports, Rapid expansion in exports is the only way Io find a permanent solution to our balance of payments problem.

14.6 CONCEPT OF THE RATE OF EXCHANGE

The term foreign exchange is normally used to denote foreign currency surrounded or asked for in any of its current forms, i.e,. a currency note or a negotiable instrument or transfer of funds through cable or mail transfer or Letter of Credit transaction requiring sale and purchase of foreign exchange or conversion of one currency into another, either at the local Centre or an overseas Centre. The banks, dealing in foreign exchange and providing fiicilities for conversion of one currency into another or vice versa, are known as Authorised Dealers in Foreign Exchange. A bank is said to buy or sell foreign exchange when it handles the claims drawn in foreign currency or the actual legal tender money. i.e., foreign currency notes and coins of other countries.

14.6.1 Foreign Exchange Rates

Dealings in the foreign exchange market are carried out at specified rates of exchange. When an exchange dealer sells to a customer or buys from him foreign exchange in ally

form, or a draft expressed in foreign currency, he quotes a rate of exchange on the basis of which the price of the instrument in the home currency is calculated. For example, if a bank in India sells a draft for 1,000 to an Indian importer, who has to remit this amount to Great Britain, and if the rate between the sterling and the rupee, quoted by the bank, is 1.8375 per Rs. 100, the customer has to pay Rs. 54421.76 in Indian currency for the draft. Thus, the rate of exchange between two currencies is the price of a unit of one currency in terms of the other.

14.6.2 Current Rate and Par of Exchange

The price of a commodity in the market changes from day to day or even from hour to hour. These fluctuations are caused by short term factors of demand and supply. But these movements are not just accidental or unpredictable but they lake place around certain definable norms, and the price tends to return to the normal. The price around which the market price fluctuates is the normal price. It is the same with the price of a currency in the exchange market. The current rate of exchange between two currencies fluctuates from day to day due to changes in demand and supply. But these fluctuations take place around a rate which may be called the normal rate, the true rate, or the par of exchange. The normal rate of the parity is determined by forces that are of a different nature from those influencing the current rate. The monetary system prevailing in the two countries whose currencies are involved in the rate of exchange has a major effect on the factors that determine the parity of exchange. Sometimes the par value or parity of a currency is fixed by exchange control. The authorities then fix the exchange value of the currency and maintain it within certain limits of the fixed rate.

14.7 MECHANISM OF EXCHANGE RATES DETERMINATION

In the exchange market the price of one currency in terms of another currency is quoted as so many units of the second currency for a unit of the first, or the other way round. This price, however, is not always the same. The study of rate mechanism focuses on the reasons as lo why banks are ready lo buy or sell a foreign currency at a particular price and why this price changes from time to time. The rate quoted by a bank is not the result of an arbitrary decision but is based on careful consideration of certain facts and forces. In a free foreign exchange market the rate of exchange, like any other price, is determined by the operation of certain forces.

14.7.1 Demand and Supply

The market price of a commodity is determined by the forces of demand **and** supply. For example, when on a particular day, due to festival or some other reason, the demand for milk in the market is higher than any other normal day, and the milk sellers feel that their stocks are not enough to meet the demand at the usual price. They rise the price of milk. On the other hand, on another day, if the demand is low and they think that they will not be able lo clear their stocks at the usual price: they lower the price. The same conditions apply in the case ot a currency in the exchange market. When there is an increase in the demand for a foreign currency, without a change in its supply, its price in terms of the home currency rises. For example, in a situation in which the banks find the demand for dollars is so high that it cannot be met at the prevailing rate of exchange, they equate demand and supply by raising the exchange value of the dollar in terms of rupees. If, on the other hand. they find that their dollar balances are larger than usual and there is not much demand for that currency, the balance between demand and supply is brought about by lowering the price of the dollar in terms of the rupee. A fall in the demand for currency in relation to its supply causes its value in the exchange market lo fall.

The demand for currency on trade account arises on account of the following factors:

i) The residents of the country have exported goods to other nations for which they have to receive payments.

ii) The shipping, banking and insurance companies of the country render services to other countries for which they receive remuneration.

iii) Entrepreneurs setting up business abroad, and supply technical personnel and managers receive profits and salaries.

iv) Tourists and students coming from abroad spend money in the country.

v) Besides the regular tourist traffic going from country to country only for tourist interests, there are certain groups travelling on cultural exchange programs under various government-sponsored delegations and private visits to friends and relatives staying in other countries also lead to the need of foreign exchange. In recent years, movement of individuals and groups on these accounts are on higher side, and the overall contribution of the exchange affecting on these accounts are figuring remarkable in overall balance of payments position under the heading of private transfers.

Similarly factors which are responsible for supply of currency against a demand for foreign currencies are:

i) Imports from other countries.

ii) Use of services by foreign shipping, banking, insurance and other services, for which payments are to be made.

iii) Payments made as salaries and profits to foreigners not staying in the same country.

iv) Residents of the country going as tourists abroad and for higher education in foreign universities and institutions spend money there.

14.7.2 Exchange Rate Determination in India

With effect from March 1, 1993 exchange rate of Indian rupee has been left free to be determined by the market forces of demand and supply, However, it does not mean that the authorities cannot intervene in the foreign exchange market. The Reserve Bank of India can, and occasionally does, intervene in the market in support of Indian rupee.

For example, if a large inflow of dollars takes place at any time in the Indian foreign exchange market Indian rupee would tend to appreciate. An appreciation of the rupee works to the disadvantage of India's exports. Exports may suffer a set-back. To prevent this from happening, the Reserve Bank may purchase dollars in the market. This will put up the demand for dollars, and hence serve to bring about stability in the rate of exchange.

Likewise, if there is a sudden increase in demand for dollars in India's foreign exchange market, Indian rupee will lose value, i.e., it would depreciate. Depreciation of Indian rupee would make India's imports costlier. This may bring inflationary tendencies in the economy. This may also increase the rupee value of India's external debt. All these adverse effects can again be prevented if the Reserve Bank releases dollars from its stocks. The supply of dollars will increase in the market. As a result, the rate of exchange will remain stable.

In short, the rate of exchange of Indian rupee is determined by the market forces of demand and supply. But the Reserve Bank of India has the right to intervene in the foreign exchange market. Intervention in the foreign exchange market assures stability in the rate of exchange.

Check Your Progress *C*

1. What do you mean by the terms 'foreign exchange' and 'rate of exchange'?

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2. How is the rate of exchange between two currencies determined?

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3. Docs Reserve Bank of India play any role in the determination of the rate of exchange of the Indian rupee? Explain briefly.

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14.8 EXPORT-IMPORT POLICY (1997-2002)

The Export Import (Exim) Policy for the five year period 1997-2002 was announced on March 31, 1997.

The principal objectives of the Exim policy are as follows:

1. To accelerate the country's transition to a globally-oriented vibrant economy to derive maximum benefits from expanding glohal market opportunities.
2. To stimulate sustained economic growth by providing access to essential raw materials, intermediates, components, consumables and goods required for augmenting production.
3. To enhance the technological strength and efficiency of Indian agriculture, industry and services, thereby improving their competitiveness, and encouragement of internationally accepted standards of quality.
4. To provide good quality products at reasonable prices.

The main features of the policy arc as follows:

1. All exporls and imports are free, subject lo the regulations imposed by the Government, except those which arc contained in the Negative List appended to the policy.
2. Items contained in the Negative List of imports can be classified in three categories:

   a. **Prohibited goods:** This category consists of a few items like tallow fat and oils, animal rennet, wild animals, ivory, etc.

   b. **Restricted items:** These items may be imported only against a freely transferable special import licence. This list consists of i) different types of consumer goods like electronic goods, telephone instruments and EPABX, watches, fabrics, concentrates of alcoholic beverages, wines, etc. ii) precious, semi-precious and other stones, iii) safety, security and other items like paper for security printing, fire arms, ammunition, explosives, etc; iv) seeds, plants and animals, v) insecticides and drugs like penicillin, tetracycline, streptomycin, etc; vi) chemicals and allied items, and vii) items relating to the small-scale sector.

   c. **Canalised items:** These goods can he imported only through the agency of some institutions and organisations specifically designated by the Government. This list contains eight groups of items like i) petroleum products, ii) fertilisers, iii) coconut oil, iv) seeds, v) all non-edible oils, vi) palm stearin and kernal oil, vii) cereals, and viii) cloves and cinnamon.

3. All goods, except those in the Negative List, may be freely imported without any restriction. Capital goods, raw materials, intermediate, components, consumables, spare parts. accessories, instruments and other goods fall in this category. Some of the important conditions attached to these goods are as follows:

   i) These goods may be imported by any person, whether he is an Actual User or not.

   ii) All second-hand capital goods, having a minimum residual life of 5 years, may hc imported by Actual Users, without a license, subject to Actual User condition.

   iii) Exporters coming from abroad are allowed to import drawings, patterns, labels, price tags, buttons, belts, required for execution of specific export orders placed on them, as part of their passenger baggage.

   iv) Imports of goods on export basis may be allowed withaut a license on execution of bond/bank guarantee to the satisfaction of the customs authorities.

   v) Goods sent abroad for repairs, testing, quality improvement or 'upgradation of techiiology may he re-imported without a license.

   vi) Capital goods, both new and secondhand, may be imported under the Export Promotion Capital Goods Scheme. Capital goods including spares, can be imported at a concessional rate of customs duty subject to an export obligation.

4. A Duty Exemption Scheme has been introduced for the exporters. The Duty Exemption Scheme consists of i) Duty Free License, and ii) Duty Entitlement Pass Book.

   i. Duty Free License includes a) Advance License, b) Intermediate License, and c) Special Import License.

   a) An Advance License is granted to a merchant-exporter or manufacturer-exporter for the import of inputs required for the manufacture of goods without payment of basic customs duty.

   b) All Intermediate License is granted to a manufacturer-exporter for the import of inputs required in the manufacture of goods to be supplied to the ultimate exporter holding an Advance License.

   c) A Special Import License is granted to a manufacture-exporter for the import of inputs required in the manufacture of goods to be supplied to EOUs. units located in EPZs, STPs or EHTPs, to projects financed by multilateral or bilateral agencies, to fertiliser plants, the power, oil and gas sectors, etc.

   ii. Under the Duty Entitlement Pass Book (DEPB) Scheme, an exporter is eligible lo claim credit as a specified percentage of job value of exports made in freely convertible currency. The credit will be available against such export-products and at such rate as may be specified by the Director General of Foreign Trade (DGFT). DEPB may be issued on a) post-export basis, and b) pre-export basis.

   a) DEPB on post-export basis is granted against exports already made,

   b) DEPB on prc-export basis aims to provide the facilities to eligible exporters lo import inputs which are required for production.

5. EOUs, units in EPZs, EHTP units and STP units can import free of duty all types of goods. including capital goods, required by them for production provided these are not prohibited items in the Negative List of Imports. Such a unit will have to he a net foreign exchange earner. Net foreign exchange earning as percentage of export (NFEP) is calculated according to the following formula:

$$NFEP = A - B / B$$

Where

A = The FOB value of exports,

and B = The sum total of the CIF value of all imported capital goods, the value of all imported inputs, **and** the value of all payments made in foreign exchange.

The entire production of these units is to be exported subject to the following conditions : a) rejects upto 5% of the value of production may be sold in the Domestic Tariff Area (DTA) b) 25% of the production in value terms may be sold in the DTA subject to payment of applicable duties.

6. The criteria for recognition as a trading house have been laid down as follows:

   Export Houses; An average export turnover of over Rs. 20 crore during the last three years.

   Trading House: An average export turnover of over Rs.100 crore.

   Super Trading Houses: An average export turnover of over Rs.500 crore.

   Super Star Trading Houses: An average export turnover of over Rs.1500 crore.

7. The Exiin Policy makes a special mention of quality awareness. The Government aims to encourage manufactures and exporters attain intenlationally accepted standards of quality for their products. The Central Government will extend support and assistance to trade and industry to launch a nationwide programme on quality awareness and promote the concept of total quality management. The Central Government will also assist in the modernisation and upgradation of test houses and laboratories in order to bring them at par with international standards.

8. No import or export can be made by any person without an Importer-Exporter Code number granted by a competent authority.

9. Private bonded warehouses can be set up in the Domestic Tariff Area. Any person can import goods which are freely importable or which may be imported against a Special Import License (SIL). A SIL entitles exporters to import consumer goods that are on the restricted list. This is how the SIL route amounts to opening up the economy to consumer goods imports.

10. Further procedural simplifications have been introduced in the policy with the decision to computerise all offices of the Director General of Foreign Trade (DGFT).

14.9 ROLE OF EXIM BANK

Export -Import Bank of India (Exim Bank) is a public sector financial institution created by an Act of Parliament, the Export -Import Bank of India Act, 1981. Exim **Bank** was set up for the purpose of financing, facilitating and promoting foreign trade of India. Exim **Bank** is the principal financial institution for coordinating the working of institutions engaged in financing export and import trade of India. The Exim Bank is to finance Indian exports that lead to continuity of foreign exchange for India. The Bank came into existence in January 1982 and coininenced operations from March 1, 1982.

14.9.1 Genesis of Exim Bank

The programmes of industrial development in India resulted in diversification and expansion of the export sector in the seventies. Development of capabilities for export of capital goods, engineering goods, manufactured products, projects and services as also setting up of joint industrial ventures abroad ate an important outcome of this process. To finance this expanding export effort, Exim Bank was set up as a specialised institution which could provide coinprehensive export credit on international competitive terms as well as offer advisory services to exporters for non-traditional exports.

Exim Bank's operational philosophy comprises five major **components.**

i) To make the Indian exporter internationally competitive on the count of financing terms offered by him;

ii) To develop alternate financial solutions for an Indian exporter in his effort to bt internationally compctitive.

iii) To provide information on export opportunities in non-traditional exports including currency advice to Indian manufacturers so that new export opportunities are pursued.

iv) To provide selective production and marketing finance for making Indian manufactured product9 internally competitive.

v) To respond to cxporl problems of Indian exporters and pursue policy resolution.

The bank is continuously building capabilities to anticipate and respond to development in export opportunities. information technology and translate national foreign trade policies.

14.9.2 Exim Bank's Lending Programmes

Exim Bank's lending programmes are oriented towards facilitating exports on deferred payment terms or for supporting overseas projects. There are six user groups on which these lending programmes are focussed i.e., Indian exporters, Indian commercial banks, overseas buyers, foreign government, international banks and overseas financial institutions.

A. Loans to Indin Exporters

i) **Supplier's credit:** Term export credits are extended to Indian exporters of eligible goods and services to enable them to offer deferred credit to overseas buyers.

ii) **Consultancy and technology services:** Exporters can avail of Exim Bank's financial assistance for offering deferred credit to overseas buyers for Indian consultancy and technology and other services.

iii) **Pre-shipment credit:** Finance is available Io companies executing contracts involving manufacturing cycle time cxceeding *6* months.

iv) **Project finance to export-oriented units:** Exim Bank provides term loan for setting up to export-oriented units, units in exporl processing zones as also domestic tariff areas (DTA), units exporting minimum 25% of their annual sales.

v) **Import finance:** Exim Bank finances imports which are export related, i.e., imports by export-oriented units, imports of computer systems for development and export of software, import of plant, machinery, technology for upgradation/ expansion of production capability for exporl markets.

vi) **Overseas investment finance:** Exim Bank provides finance to Indian companies towards their equity participation in joint ventures abroad.

B. Loans to Commercial Ranks of India

i) **Export hill rediscounting:** Commercial banks in India which are authorised to deal in foreign exchange can rediscount with Exim Bank their short-term export bills with usance period not exceeding 180 days. The rale of interest change ranges from 12% to 16% depending upon the usance.

ii) **Small Scale Industry (S.S.I):** Export bills rediscounting. Same as above, specifically in respect of SSI bills.

iii) **Refinance of export credit:** Authorised dealers in foreign exchange can obtain from Exirn Bank, 100 per cent refinance of deferred payments loans extended for export of eligible Indian goods,

iv) **Refinance of term loans:** Term loans to eligible export-oriented units. Computer software exporters can be refinanced in full by Exim Bank.

C. Loans to Foreign Governments, Importers and Financial Institutions

i) **Overseas buyers' credit:** Credit is offered directly to foreign entities for import of eligible Indian goods and related services.

ii) **Lines of credit:** Provision of term finance for import of eligible Indian goods and related services to foreign government and financial institutions.

iii) **Relending facility to banks overseas:** Relending facility is extended to enable international banks to provide term finance to their clients overseas for import of eligible Indian goods.

D. Guaranteeing of Obligation

Exim Bank also participates with commercial banks in India in issue of guarantees such as advance payment performance, retention money and guarantees for borrowing abroad for execution of export contracts.

Check Your Progress D

1. Whal are the main features of the Exim Policy 1997-2002?

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2. What role does Exim Bank play in the promotion of India's foreign trade?

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3. Fill in the blanks:

   i) The Exim policy aims to accelerate the country's transition to a .... oriented vibrant economy.

   ii) ....goods can be imported only through an agency designated by the government

   iii) All .... license is granted to a manufacturer-exporter for the import of inputs.

   iv) Duly Entitlement Pass Book (DEPB) on post-export basis is granted against .... already made.

   v) The Exim Bank is to finance Indian exports that lead to ....of foreign exchange for India.

14.10 LET US SUM UP

Like any other developing economy, India has been faced with the problem of deficits in balance of payments. Deficit funding has been becoming increasingly difficult in recent years. As a result India has formulated a policy to solve this problem. The policy has been successful to a large extent. Among the various policy measures, important ones have been market determination of the rate of exchange, setting up of the Exim Bank to finance foreign trade and a comprehensive long-term foreign trade policy. India has also benefited from its membership of the various international financial institutions.

14.11 KEY WORDS

Balance of Trade: All annual accounting statement of the monetary value of Lotal exports and imports of goods by a nation.

Balance of payments: All annual accounting statement of all monetary transactions of a country with the rest of the world.

Foreign Exchange: Units of currency of other countries.

Rate of Exchange: Number of units of foreign currency that can he exchanged for a unit of domestic currency.

Exchange Control: A system whereby all the foreign exchange transactions can be carried out only after a formal permission from a competent authority.

Negative List: It contains list of' those commodities whose exports (or imports) are prohibited, restricted or canalised through an organisation.

14.12 ANSWERS TO CHECK YOUR PROGRESS

B 3. i) False, ii) True, iii) True, iv) False, v) False

D 3. i) Globally, ii) Canalised, iii) Intermediate, iv) Exports, v) Continuity

14.13 TERMINAL QUESTIONS

1. Explain in detail the distinction between current account and capital account.
2. Define the term 'balance of payments' and explain its significance.
3. Briefly mention the causes of BOP deficits. What are the measures adopted to solve the above problem?
4. Explain the concept of rate of exchange. What is the mechanism for determination of exchange rates. Explain how the exchange rates are determined in India
5. Give the main features of Exim Policy 1997-2002.
6. Explain in detail the role of Exim Bank in India's foreign trade.

Note: These questions will help you to understand the Unit better. Try lo write , answers for them. but do not send your answers to the University. These are for your practice only.

UNIT 15 INTERNATIONAL TRADE RELATIONS

Structure

15.0 OBJECTIVES

After studying this unit, you should be able lo:

- explain the concept of bilateral lrade relations
- distinguish between bilateral trade relations and multilateral trade relations
- point out the relative merits and demerits of bilateral trade relations and multilateral trade relations
- describe the structure of WTO
- distinguish between the GATT and the WTO.

15.1 INTRODUCTION

As we approach the end of the twentieth century 'export-led-growth' as a strategy of rapid economic growth has acquired universal acceptance. All the nations, hig and small, are orienting their economies to meet the global needs. be it the primary commodities or manufactured goods. Likewise, services too arc being evolved and organised to meet the global needs.

With this realisation dawning on the nations that exports hold the key to rapid economic growth the number of players on the international trade scene is continuously increasing. The international trade scene is a fiercely competitive world. Evcty player tries to undercut tbc other, Every possible technique is employed lo cultivate market for one's own product.

With so many sellers fiercely fighting for consumer's dollars, it is only necessary that

some rules and regulations are stipulated. Each country lays down such rules and regulations for its domestic producers. But its writ runs only within its physical boundaries. Beyond these, it cannot regulate the activities and behaviour of others, in the given situation, where the interests of producers and consumers cut across different nations, regions and continents, it is necessary that a set of rules and regulations are evolved that apply to all of them. This is possible only when nations cooperate among themselves, they may reach agreements that provide a set of rules that would be binding on them all alike. Such agreements may be reached at between two countries or a large number of countries. The former are known as **bilateral** agreements while the latter are known as **multilateral** agreements. Such agreements form the basis of what is known as the **international trade accord.** Such an accord is presently embedded in what is known as the World Trade Organisation (WTO).

15.2 BILATERAL TRADE RELATIONS

Two nations may get into some agreement among themselves in regard to mechanism of trade. Such an agreement may stipulate the type and volume of each of the goods to be exported and imported by each of the contracting parties. They may also stipulate the stage-wise time frame for the contract.

More generally trade agreements also involve 1) counter trade, 2) payments agreement and 3) swing credit.

1. **Counter Trade** is **a** form of barter trade. The two nations may decide upon the volume of goods that would be exported and imported during a specified period. The countries may also decide upon the prices of each of the goods to be traded in. The volumes of different goods to he traded may he so fixed that the net trade would be in balance. Goods would have to he paid for the goods by both the trading nations.
2. **Payments agreement** may stipulate the currency in which the trade transactions have to he accounted for. The currency may be that of one of the contracting parties or it may he one of the hard currencies that ate internationally accepted as a medium of excliangc. The agreement may also provide for the mechanism to be adopted if the bilateral trade is not in balance.
3. **Swing credit** is provided for when the trade between the two contracting parties is not in balance. The country with a deficit in its trade may be permitted to carry it in the next accounting cycle. As long as the agreement provides for the swing credit the trading nations are under no immediate pressure to balance the trade. Of course, in the long run all trade is to he balanced hy paying for the deficits, either, by net exports or in terms of a mutually agreed upon foreign currency.

Bilateral trade has been used as a mechanism to promote trade between nations. It is even now one of the common devices. But bilateral mechanism has its inherent **limitations.**

One, bilateral mechanism is not an efficient way of utilisation of a country's resources. The theoretical basis of trade between two countries is the idea of comparative advantage. A country exports the commodity or commodities in which it has a comparative advantage over its trading partner. Similarly, it imports those commodities in which the trading partner has a comparative advantage. In a bilateral trade mechanism, comparative advantage comes to be limited as between two nations only. This may happen that country 'A' may he one of the most inefficient producers of a commodity on the global scene, but by matter of the fact that it has a comparative advantage over country B, trade between the two countries will take place. Since the producers in the two countries are in a position to find a market for their respective products there is no sufficient inducement for them to improve their efficiency. Lack of efficiency results in less-than-optimum use of resources. A multilateral trading system prevents this wasteful use of resources.

Two, it follows from the above that the volume of trade will tend to grow less and be slow under a bilateral system, The domestic producers in both the countries will tune themselves only to the requirements of the trading partner. Possibly both of them may be inefficient producers in the global perspective. They will fail to cultivate markets outside the agreement areas. Hence. given that the absence of competition does not spur them to adopt any innovations to improve their efficiency, they may Pail to take advantage of the expanding global markets.

Check Your Progress A

1. What do you mean by bilateral trade relations?

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2. Explain the meaning of following terms :

   i) Counter trade

   ii) Payments agreement

   iii) Swing credit

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15.3 MULTILATERAL TRADING SYSTEM

Multilateral trading system is one in which a large number of nations interact with each other, More generally, a multilateral trading system is like a large free market with physical boundaries removed as far as the transactions in and movement of goods are concerned. Goods flow freely between nations. Goods produced in country **A** compete freely for the consumer's dollars with the goods produced in any other country globally. There are no barriers on the flow of goods.

Apparently, the model of free trade is based on the assumption that all the nations have a glohal view of the use of resources. Free trade among nations assures that the available resources are put to their best possible use.

15.3.1 Advantages of Free Trade

The advantages of free trade between large number of nations can be summerised as follows:

i) There are static gains from free trade. The static gains are those which accrue from international specialisation according to the doctrine of comparative advantage.

ii) There are dynamic gains from free trade. The dynamic gains are those which result from the impact of trade on production possibilities at large. Economies of scale, international investment and the transmission of technical knowledge would be examples of dynamic gains.

In addition, free trade can provide a vent for surplus commodities, which brings olherwise unemployed resources into employment, and also enables countries to purchase goods from abroad, which can be important for two reasons. The *first* is that if there are no domestic substitutes, the ability to import can relieve domestic bottlenecks in production. The second is that imports may simply be more productive than domestic resources.

15.3.2 Disadvantages of Free Trade

The doctrine of free trade is not a very useful concept to employ in the context of developing countries which are in the process of rapid structural change and which are concerned more with long-term development than with short-term efficiency. The doctrine of free trade over looks many development considerations.

i) it ignores the balance-of-payments effects of free trade and the effect of free trade on the terms of trade. If the demand for different commodities grows at

different rates owing to differences in their price and income elasticity of demand, free trade will work to the benefit of some countries and to the relative detriment of others.

ii) free trade could lead to excessive specialisation on a narrow range of products, putting the economy at the mercy of outside influences. The possibility of severe balance-of-payments instability resulting form specialisation may be damaging to.development.

iii) export growth of some activities has relatively little secondary impact on other activities. The free-trade doctrine overlooks the secondary repercussion of the pattern of trade.

In view of the above difficulties associated with free trade, many countries, including developed and developing for their own reasons, have been placing harriers on the free flow of goods and services. These barriers are often called by the name of **protection,**

15.3.3 Arguments for Protection

We can summarise the arguments for protection as follows:

First, there is a category of purely economic arguments that comprise all those arguments for protection as a means of increasing real output or income above what it would otherwise be. These include:

i) the infant argument, to allow industries to reap their optimum size in terms of minimum average cost of production;

ii) the existence of external economies in production, where the social cost of production is less than the private cost;

iii) distortion in the labour market, which make the social cost of using labour less than the private cost; and

iv) international distortions which cause the domestic rate of transformation between goods to diverge from the foreign rate of transformation due, for example, to monopoly power in international trade. · This argument for protection is often referred to as the optimum tariff argument.

Secondly, there is a category of non-economic arguments for protection which comprise arguments for protection for its own sake rather than to increase output or income above what it would otherwise be. For example, industrialisation at any price, or self-sufficiency for strategic reasons, would be arguments of this type.

15.3.4 Instruments of Protection

Different instruments of protection are employed by countries. These can bc broadly classified in two groups, viz. 1) Tariffs, and **2)** Non-tariff harriers.

1) **Tariffs:** Tariffs are the most common instrument of commercial policy, Tariffs are essentially the taxes or duties imposed on the imported or exported goods. . Import duties are more common than export duties, so much so that tariffs are often identified with import duties. Tariffs are aimed at altering the import price (or the export price) so as to regulate the volume of imports (or of exports). Their aim is to alter the volume of imports from a position where they would otherwise be, if the trade was free from tariff restrictions.

   Whatever the motives behind tariff imposition or increase, their effect is necessarily one of creating trade distortions. Tariffs raise the prices of imported goods, and by making imported goods more expensive they hope to a) discourage domestic consumers for consuming foreign goods, and b) encourage consumptiou and production of the domestically produced import replacement substitutes. Tariffs would, therefore, distort the world comparative advantage pattern hy discouraging efficient production (in the rest of the world) and encouraging inefficient production (in the home country). Similarly, tariffs lead to a fall in the volume of international trade, preventing the countries from obtaining gains from trade (i.e. the gains arising pattly out of exchange and partly from specialisation adding up to total gains from trade).

Tariff barriers increase the economic distance between nations, and to that extent create obstacles to trade far beyond the distance created by natural geographical separation between countries. The effects of tariffs are identical with those of transport costs insofar as both raise import (or export) prices of internationally traded goods and services.

Non-tariff barriers: while tariffs constitute 'visible' barriers to trade. the non-tariff barriers, by contrast, constitute the hidden or 'invisible' barriers to trade. In more recent years, these non-tariff barriers have come into greater prominence than the conventional tariff barriers. The lion-tariff barriers mainly include direct restrictions (the so-called quotas), monetary restrictions, and technical and administrative regulations.

Quantitative restrictions, or quotas, arc imposed with a view to reduce the quantity of imports (or exports) to a limited size. The effect of quotas are more severe than those which are created by tariffs. Import quotas are more common than export quotas. The world has witnessed severe import quotas of the mandatory type (by the importing countries) as well as the so-called 'voluntary restraints' on the exports (of the exporting countries). In the case of voluntary restraint countries put voluntary restraints on their exports. There is not much difference between the mandatory import quotas and voluntary export restraints, except thal the latter are more refined while the former are more crude. Their effect on trade is the same, viz, trade-restrictions and trade-distortion, causing misallocation of world resources and reducing global welfare.

Monetary restrictions are another form of non-tariff barriers. Even though there are no tariffs or no quota restrictions on the volume of imports, a country can impose foreign exchange controls to accomplish precisely the same effects of limiting the volume of imports. The importer needs foreign exchange to import foreign goods, and the government of the country can deny Lhe use of foreign exchange for certain types of imports or for goods imported from certain countries. By exercising such controls over the use of foreign exchange (they are called exchange controls) the governinenl of the country can restrict the volume of trade. Exchange controls are quite widespread, particularly in the poor countries which experience severe shortage of foreign exchange.

The third form of non-tariff barriers includes administrative and technical regulations. They include custom restrictions on bringing goods that do not meet the safety and health regulations in the country. In addition, there are administrative regulations as opposed to regulations based on ostensible technical grounds (of health, safety, etc,). They include regulations with regard to labelling, packaging, custom formalities and endless columns to be filled in several forms by the one who is importing goods, etc. Very often, there is administrative delay, red-tape and corruption in customs clearing. All of these could be so annoying and frustrating that the potential importers get thoroughly disgusted, and in the end, they give up the idea of importing any thing at all, All of them constitute hidden barriers to free movement of goods and services between the countries. Their effecl is the same as that of tariffs or any other instrument of trade restrictions.

Finally, there are government procurement policies, or stale trading practices, which are common to many nations. These policies involve giving preferences to domestic producers for government procurement. In accepting public tenders, government give preference to the local tenders rather than the foreign tenders. Additionally, many governments practice policies of granting production subsidies, tax concessions and other fiscal and monetary incentives to encourage export expansion or import substitution. They may not he directly aimed at reducing or distorting the trade volume or pattern or direction, but, in effect, they amount to the same.

All of these measures, besides several other dozens, constitute the so-cJled 'hidden' non-tariff obstacles to international trade. They are all man-made; and the human action has not been sufficient in the direction of trying to reduce the economic distance which these artificial barriers have created and enlarged over

the past several years.

Check Your Progress B

1. State the advantages and disadvantages of free trade.

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2. What are the main arguments in favour of protection?

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3. What are the major instruments of protection?

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4. Fill in the blanks:

   i) The static gains from free trade accrue from international ....

   ii) Free trade can provide a vent for .... commodities.

   iii) .... are essentially the taxes or duties imposed on the imported or exported goods.

   iv) Tariffs encourage the consumption and production of the domestically produced import replacenlent .

   v) Monetary restrictions are a form of .... barriers.

15.4 GENERAL AGREEMENT ON TRADE AND TARIFFS (GATT)

The world trade had badly suffered on account of the restrictive trade practices adopted by the different countries during the World War II. Countries were keen to set a new system of world trade where dangerous protective practices could be avoided and the world community may have the benefits of free trade.

The General Agreement on Trade and Tariffs (GATT) was concluded in Havana in 1947 after a series of negotiations between the participating countries. The membership of the GATT as on April, 1995, was 121 which together account for about 90 per cent of world trade.

15.4.1 Objectives of GATT

The main objective of the GATT is explained in the preamble of the Agreement which reads as follows; "Their relations in the field of the trade and economic endeavour should be conducted with a view to raising standard of living ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources

of the world and expanding the production and exchange of goods, and promoting the progressive development of the economies of all the Contracting Parties".

In short, the GATT aims at expanding the volume of international trade, production, employment and making full utilisation of world resources for raising standard of living of the world community as a whole.

The member-countries have entered into agreements in respect of the following:

i) The principle of 'most favoured nations' has been adopted. This means that any concession which a country may give to any of the members would, with certain exception, be automatically given to other member-countries as well.

ii) Protection to domestic industries should not be given on the basis of quantitative restrictions such as quota, exchange controls, etc. Only tariffs should be imposed to protect the domestic industries.

iii) The contracting parties should sort out their differences hy utilising the good offices of the GATT. They themselves should not adopt or initiate retaliatory action against each other.

iv) All the member-countries should jointly try to expand world trade along with healthy lines.

15.4.2 Role of GATT

Although the plans to establish an International Trade Organisation (WTO) after World War 11 failed and the GATT came into existence only by virtue of Protocol of Provisional Application. The contractual rights and obligations of members embodied in the General Agreement have provided a substantial degree of order in world trade relations. GATT members have benefited from neutral forum and set off rules to which national authorities could resort: if needed, to fortify themselves against pressures from domestic protectionist lohhies.

15.5 WORLD TRADE **ORGANISATION (WTO)**

The International Trade Organisation (ITO) originally, was proposed to be set up along with the World Bank and the IMF on the recommendations of the Bretton Woods Conference, 1944. But as the ITO could not he set up the US, UK and a few other countries set up an interim organisation in 1947 about trade named GATT. The GATT was biased in favour of the developed countries and was called informally as the 'rich men's club'. The developing countries insisted on setting up of the ITO; the move came to he opposed by the US. To solve the issue the UN appointed a Committee in 1963; the Committee recommended as possible alternative a via media, United Nations Conference on Trade and Development (UNCTAD). The UNCTAD could manage to get some concessions for the developing countries. more important among which was the General Scheme for Trade References (GSTP). GATT was also made progressively more liberal. The Uruguay Round of GATT sought to expand the scope of the organisation hy including services. investment and intellectual properly rights. The Uruguay Round proposals were accepted hy all the members of the GATT in March 1994.

The Uruguay Round agreement provided for the setting up of the World Trade Organisation (WTO). The WTO started functioning from January 1, 1995.

15.5.1 Functions of the WTO

The WTO performs the following functions:

i) It administers, through various councils and committees. the 28 agreements contained in the final act of the Uruguay Round of World Trade talks plus a number of plurilateral agreements, including those on government procurement.

ii) It oversees implementation of the significant tariff cuts (averaging 40 per cent) and reduction of non-tariff measures agreed to in the trade negotiations.

iii) It is a watchdog of international trade. regularly examining the trade regimes of individual members.

iv) Members are required to notify in detail various trade measures and statistics, which are maintained by the WTO in a large data base.

v) It provides several conciliation mechanisms for arriving at an amicable solution to trade conflicts among members.

vi) Trade disputes that cannot be solved through bilateral talks are adjudicated under the WTO dispute settlement 'court'.

vii) Panel of independent experts are established to examine disputes in the light of WTO rules and provide ruling. The tougher, streamlined procedure ensures equal treatment for all trading partners and encourages members to abide by their obligations.

viii) The WTO is a management consultant for world trade. Its economists keep a close watcli on the pulse of the global economy and provide studies on the main issue of the day.

ix) The WTO secretariat assists developing countries in implementing Uruguay Round results through a newly established development division and a strengthened technical cooperation and training division.

x) The WTO is a forum where countries continuously negotiate the exchange of trade concessions to trade restrictions all over the world. The WTO already has substantial agenda for further negotiations in many areas, notably certain services sectors.

The agreement establishing WTO reiterates the objectives of GATT:

a) Raising standard of living and incomes, ensuring full employment, expanding production and trade, optimal use of world's resources, at the same time extending the objectives to services and making them more precise.

b) Introduces the idea of sustainable development in relation to the optimal use of world's resources, and the need to protect and preserve the environment in a manner consistent with the various levels of national economic development.

c) Recognises the need for positive effort designed to ensure that developing countries, especially the least developed ones, secure a better share of growth in international trade.

The WTO will continue the decision making practice followed under the GATT. Decision will be taken by a majority of votes cast on the basis of one country, one vole.

15.5.2 WTO Agreements

A. *WTO* Agreements Covering Trade in Goods

1. GATT 1994; The cornerstone of trade relations is the area of goods. Differential and more favourable treatment to under developed countries (UDCs) and to less developed countries (LDCs) is permitted under the 1979 Enabling Clause with respect to tariffs in the context of the General Scheme of Preferences (GSP) aud non-tariff measures, notwithstanding the Most Favoured Nation (MFN) clauses, and with respect to regional or global arrangements concluded by UDCs.

2. Trade Related Investment Measures (TRIMs) are required to be notified and eliminated within a transition period of two years (developed countries), or five years (developing countries). A further extension many be requested by developing and least-developed countries. The Agreement of Safeguards prohibits the use of 'grey-area measures', such as voluntary restraints or orderly marketing arrangements; such measures are to be notified and eliminated.

3. Agreement on Textiles and Clothing provides for the eventual elimination of the Multi-Fibre Arrangement (MFA) after a ten-year transition period. In place since 1973, the MFA currently groups eight importers; of these, Austria, Canada, the European Community, Finland, Norway the United States apply restrictions under the MFA, while Japan and Switzerland do not. The other participants in

the MFA are exporters (mainly UDCs), whose exports or part of their exports covered by the MFA are subject to bilaterally agreed quantitative restraints or unilaterally sponsored restraints on imports, typically applies at the product level but in some cases to various aggregates as well.

B. Trade in Services

The General Agreement on Trade in Services (GATS) is the first multilateral agreement on trade that has as its objective the progressive liberalisation of trade in all service sectors and the supply of services in all forms.

C. Other Issues

The WTO reached at an Information Technology Agreement (ITA) in mid-December 1996 meeting at Singapore. It seeks to eliminate tariffs on the rapidly growing $ 600 billion world market in computer-related products. Other issues on which the deliberations are being carried out at WTO are: (1) Multilateral Agreement on Investments (MAI); the MAI aims to give MNCs the right to establish any business in any country without being discriminated against hy virtue of being foreign MNCs. It would also give member states the right to settle any dispute arising out of non-compliance with the MAI at the WTO. (2) Core labour standards; these provide that wages and working conditions must prevail. (3) Trade and environment, and (4) Government procurement policies that should aim at weeding out corruption at governmental level.

These issues were originally discussed at the Uruguay Round. But these were given up in face of strong opposition from the developing countries including India and have since been revived at the Singapore Convention.

15.5.3 Evaluation

The WTO is different from and an improvement over the GATT in the following respects:

i) The WTO will be more global in its membership.

ii) The WTO has introduced commercial activities into the multilateral trading system.

iii) GATT provisions in case of disputes were time-consuming, GATT could levy penalties only through unanimous decision, which were virtually impossible. Under WTO, unanimous decisions are no longer desired; all disputes are to be settled within 18 months.

iv) WTO has one-country one-vote principle, unlike in the World Bank and IMF where the economic strength of rich countries translates into a voting majority.

WTO is expected to contribute to a necessary strengthening of the global trading system, with stronger procedure for settling disputes, a mechanism for reviewing country's trade policies, and greater involvement of ministers in decision-making.

WTO is likely to generate global income gains of up to $ 200 billion a year. In co-operation with the World Bank and the IMF, the WTO is likely to be a very powerful body.

However, with the new Trade Related Intellectual Property Rights (TRIPs), TRIMs, General Agreement on Trade in Services (GATS) and GATT conditionalities embodied in the WTO, the clout of the MNCs is likely to increase enormously. Smaller developing countries in particular will become a plaything of the MNCs. A few bigger developing countries like China, India, Brazil, etc., with large home market and large protected base for production for export to the neighbouring regions may get a somewhat better deal from the MNCs. But that would also depend upon the strength and integrity of their goverments, their capacity to mobilise the support of other concerned governments, lmplement firmly anti-monopoly and restrictive practices and laws and promote competition between the MNCs from different countries as well as national corporations.

Check Your Progress C

What is GATT?

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2. Briefly mention the functions of WTO.

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3. Explain how WTO is different from GATT?

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4. State whether the following statements are True or False.

   i) According to GATT, protection to domestic industries should be given on the basis of quantitative restrictions.

   ii) GATT was biased in favour of the developed countries.

   iii) WTO provides several conciliation mechanisms for solving trade conflicts among members.

   iv) The WTO will not continue the decision making practice followed under the GATT.

   v) GATS is the first multilateral agreement whose objective is the progressive liberalisation of trade in all service sectors.

   vi) The WTO has introduced commercial activities into the multilateral trading system.

15.6 LET US SUM UP

Foreign trade has universally come to be accepted as an instrument of economic growth. Multiple expansion in the flow of goods has made il imperative that barriers on the flow of goods has made it imperative that barriers on the free flow of goods are removed. In recognition of this need. bilateral and multilateral arrangements have been evolved. These have sought to protect the interests of trading nations. GATT and more recent WTO are examples of international trade accord.

15.7 KEY WORDS

Bilateral Trade Relations: Trade limited to between two countries.

Multilateral Trade **Relations:** Flow of goods between a number of nations

Counter Trade: Exchange of goods for goods between two nations.

Free Trade: A situation where no restrictions are placed on the flow of goods between nations

Protection: A situation in which barriers are placed on the flow of goods and services.

Tariffs: Imposition of customs duties on imports of goods from other countries.

Non-tariff Barriers: Restrictions placed on the flow of goods from abroad.

15.8 ANSWERS TO CHECK YOUR PROGRESS

B. 4. i) specialisation, ii) surplus, iii) tariffs, iv) substitutes, v) non-tariff

C. 4. i) False, ii) True, iii) True, iv) False, v) True, vi) True.

15.9 TERMINAL QUESTIONS

1. Explain the concept of bilateral trade relations. Distinguish between bilateral trade relations and multilateral trade relations.
2. Point out the advantages and disadvantages of free trade.
3. Discuss in detail the tariffs and non-tariff barriers.
4. What axe the objectives of GATT? Briefly describe the role of GATT.
5. Write an elaborate note on the functions of WTO.
6. The WTO is different from and an improvement over GATT. How? Explain.

Note: These questions will help you to understand the Unit better. Try to write answers for them, but do not send your answers to the University. These are for' your practice only.

UNIT 16 NEW ECONOMIC POLICY

Structure

16.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the need for New Economic Policy
- describe the nature and scope of New Economic Policy
- state the progress and problems in the implementation of the New Economic Policy
- make an assessment of New Economic Policy

1.1 INTRODUCTION

Theearlier policies of public sector expansion created an inefficient public sector which incurred losses. A system of licensing and controls resulted in inhibiting investment by private sector and also discouraging foreign investment into the country. Thus there was a need to review the economic policies followed during the first three decades of development with a view to improving growth and efficiency. As a result of this, the government initiated the New Economic Policy. In this unit, you will study the nature and scope of the New Economic Policy. The progress and problems in the implementation of the policy will he highlighted and also an assessment of the policy be made.

16.2 NEED FOR NEW ECONOMIC POLICY

The economic policy initiated under the leadership of late Prime Minister Jawaharlal Nehru had provided i) a big role for the public sector in the establishment of heavy and basic industries, ii) the expansion of the role of state via public sector for the erection of hydro-electric power projects, irrigation dams, roads and communication, iii) the expansion of the role in the creation of social infrastructure in the form of schools, colleges, universities, technical and engineering institutes and in the sphere of health in the establishment of primary health centres, hospitals and medical institutions to train doctors, nurses and other supporting staff.

Although the rest of the economy was left open for the private sector, a systeln of

regulations and controls was introduced. This led to the establishment of licence and permit *raj*. Both the bureaucrats and the politicians began to thrive on the basis of the licensing system.

There is no doubt that the economic development promoted under the leadership of the state did result in the creation of an industrial base in the form of heavy and basic industries. It did help to create infrastructure in the form of roads, railways, communications, irrigation and hydro-electric works, thermal power generation plants and it did help to expand educational and health facilities. At the same time it also created certain **problems.** They were :

1) The expansion of the private sector investment was inhibited by the excessive controls and licensing policy.

2) Public sector investment, although huge, yielded poor rate of return. Public sector was plagued by inefficiency and bureaucratic rules and procedures.

3) Public sector enjoyed a monopoly in all areas which were reserved for it. The denial of competitive private sector units did not create consciousness to reduce costs.

4) Private sector investment in big projects could not be undertaken by large industrial and business houses on account of the Monopolies and Restrictive Trade Practices (MRTP) Act, (1970).

5) Foreign investment, also got discouraged due to the existence of very intricate licensing and other regulations.

All these factors necessitated the need for change in economic policy which should, on the one hand reform the public sector and on the other hand open areas restricted for the entry of the private sector - both Indian and foreign. There was a need to review the economic policies followed during the first three decades of development with a view to improving growth and efficiency.

Check Your Progress A

1. List three major elements of economic policy followed in the first three decades of development.

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2, Briefly enumerate the major problems resulting from the economic policies carried out during 1950-51 to 1984-85.

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16.3 NATURE AND SCOPE OF NEW ECONOMIC POLICY

The nature of New Economic Policy (NEP) lies in the opening of the private sector into areas hitherto reserved for the public sector. It also implied an encouragement of **the** private sector by dismantling the system of licensing and controls. For loss making units in the public sector, there was a need either to reform the working of the public sector units or close them down or transfer their ownership to the private sector. To improve technology, it was necessary to facilitate the flow of foreign investment. The nature of the NEP necessitated four kinds of changes. They are as follows:

i) Liberalisation

ii) Reform of the Public Sector

iii) Privatisation

iv) Globalisation

Thus, the scope of new policies was laid down by the above four processes of change to be initiated. They aim to remove the obstacles to growth and to promote efficiency both in the public and the private sectors by the use of market mechanism.

NEP was initiated in 1985 by late Prime Minister Rajiv Gandhi. He made a very powerful and forthright statement in his first broadcast to the nation: 'The public sector has entered into too many areas where it should not be. We shall open the economy to the private sector in several areas hitherto restricted to it'. This led to the announcement of a number of measures to remove controls and open areas to the private sector. Some of the measures undertaken by the government were:

i) Cement was decontrolled and a number of licences were issued to the private sector to expand the production of cement.

ii) The share of free sale sugar was increased to help sugar industry.

iii) 94 drugs were delicensed and 27 industries were freed from the purview of the MRTP Act.

iv) The ceiling of asset limit of big business houses was raised from Rs. 20 crores to Rs. 100 crores.

v) Electronics industry was freed from MRTP Act and the entry of foreign firms was welcomed.

Mr. Rajiv Gandhi did not push the process of economic reforms further, more explicitly on the issue of privatisation and globalisation. It was only when Mr. Narsimha Rao took over as Prime Minister in 1991 that a sharp and basic departure from the earlier economic policy was made. Let us now take up the major issues which fall within the scope of NEP: liberalisation, reform of public sector, privatisation and globalisation.

16.3.1 Liberalisation

The main aim of liberalisation was to remove unnecessary shackles on freedom of setting up enterprises. The country, during the first three decades of development had created a licence-permit raj — the rule of the bureaucracy to grant a licence to start an undertaking.

Similarly, if big business houses intended to set up a new enterprise, their applications were sent for the scrutiny of the Monopolies and Restrictive Trade Practices (MRTP) Commission. Under the MRTP Act, if the assets of a business house were more than the prescribed ceiling of Rs. 100 crores, its application was rejected. This prevented big business houses to undertake big investment in projects of infrastructure of heavy industry. There was a need to review this. The government thought it desirable that this limit should be abolished so that private sector could establish big projects in the core sector — heavy industry, infrastructure, petrochemicals etc. The government considered the ceiling limit as irrelevant and a hindrance to investment in the context of the new wave of liberalisation.

The Industrial Policy of 1991 abolished industrial licensing for all projects except a small list of 18 industries. Three major items viz., motor cars, white goods (which include refrigerators, washing machines, air conditioners, micro wave ovens etc.), raw hides and skins and patent leather were also removed from the list of reserved items. On account of the growth of a large middle class of 100 to 120 million, the demand for cars and other white goods has been growing in India. White goods are no longer considered to be luxury goods, but are considered essential for reducing the burden of domestic work. Cars are considered as status symbol by the middle class. To meet this demand, the government decided to abolish licensing in these commodities. Similarly, raw hides and skins and patent leather which are inputs in the production of shoes which have a large export demand have also been freed from licensing. To enable firms to set up new units or expand existing units, the government decided to abolish licensing in this area.

16.3.2 Reform of the Public Sector

The reform process has undertaken several measures with respect to public sector. The major **measures** are:

i) The areas of public sector will be restricted to strategic, high tech and essential infrastructure. Some of the areas hitherto reserved for the public sector will be opened for the entry by the private sector.

ii) Public sector enterprises which are chronically sick will be referred to Board for Industrial and Financial Reconstruction (BIFR). In case, the Board declares them non-viable, they will be wound up. But in case, the Board advises that there is a possibility of their revival, then, revival/rehabilitation schemes will be implemented. In any case, workers rendered surplus will be provided relief by a social security mechanism.

iii) To improve efficiency and link the interests of workers, a part of the shares will be offered to the workers.

iv) To raise resources for public sector units, the public sector management will be permitted to take the help of mutual funds and other financial institutions by offering them a share in ownership.

v) Public sector management will be made more professional and would be granted greater autonomy in decision making.

vi) Public sector units will sign a Memorandum of Understanding (MoU) with the government so that they are autonomous on the one hand and accountable on the other.

16.3.3 Privatisation

Privatisation is the process by which the ownership of a public sector unit is transferred to the private sector.

When 100 per cent ownership is transferred, it is a case of **denationalisation.** When less than 100 per cent or more than 50 per cent ownership is transferred, it is a case of partial privatisation with private sector majority-ownership of shares. In this situation, the private sector can claim to possess substantial autonomy in its functioning.

When less than 50 per cent ownership is transferred hut it is more than 24 per cent, it is a case of partial privatisation. However government continues to be a majority owner and as per rules, the undertaking retains its character as a public sector enterprise.

When the government disinvests its shares to the extent of 5 to 10 per cent to meet the deficil in the budget, this is described as **deficit privatisation.** It is also referred to as **token privatisation** because there is no substantial transfer of shares to the private sector.

The various forms of privatisalion described above pertain to transfer of ownership of public sector undertakings either wholly or parlially. This is considered to be a narrow view of privatisalion. But in a hroader sense. privalisation implies the opening up of the private sector in more and more areas hitherto reserved for the public sector. Such a policy, if pursued for a decade or more, would eventually result in increasing the share of the private sector in total investment in the economy. In this hroader sense, the process of privatisalion of the economy will lead lo enlargement of the share of private sector while the share of the public sector will register a decline ovm a long period since its areas of operation get narrowed down.

16.3.4 Globalisation

The term globalisation refers to the process of opening up of the economy to the rest of the world economy so that a free flow of goods and services, technology and investment can take place. The basic purpose of globalisation is lo integrate the Indian economy with the rest of the world. It has four **components:**

i) Reduction of trade harriers so as to permit free flow of goods and services across the border;

ii) Creation of an environment in which free flow of capital can take place;

iii) Creation of an environment in which free flow of technology can take place; and

iv) Creation of an environment in which Sree flow of labour can Cake place among different countries.

The supporters of globalisation, more especially from the developed countries restrict the definition of globalisation to only three components, namely. free trade flows, free capital flows and free technology flows. However, the economists from the developing countries desire that the fourth component, i.e.., free tlow of labour is also included. The developed countries argue that a free flow of labour would result in a very large inflow of labour from developing countries and they may not be able to accommodate such a large number. In case, free flow of labour is permitted, this may result in a decline in the wages of the native labour, because equally efficient persons from developing countries may he prepared to work at relatively lower wages. The fear of a fall in the standard of living of the native labour prevents the developed countries to have free entry. They, therefore, follow a selective approach. But the developing countries argue that the developed countries hy offering higher wagcs to highly skilled labour from the developing countries are causing a 'brain drain' and thus suck away the cream of the talent and expertise from these .countries.

Check Your Progress B

1. What are h e main elements of the policy of liberalisation? Stale them briefly.

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2. What is privatisation? List the various forms of privatisation.

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3. Distinguish between privatisation of an individual public sector unit and privatisation of the economy.

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4. Fill in the blanks:

i) The areas of public sector will be restricted to ....high tech and essential infrastructure.

ii) Public sector enterprises which are chronically ....will be referred to BIFR.

iii) Privatisation is the process by which the ....of a public sector unit is transferred to the private sector.

iv) The basic purpose of globalisation is to .... the Indian economy with the rest o f the world.

v) According to developed countries, the definition of globalisation is restricted to the three components, namely, ..., ... and ....

16.4 PROGRESS AND PROBLEMS IN THE IMPLEMENTATION OF NEW ECONOMIC POLICY

The Government of India has undertaken several steps to implement the NEP. Let us study them in detail.

1) **Liberalisation of the economy:** The Government has liberalised the regulatory framework by abolishing licensing in all industries except 15 industries, This has provided enough freedom of enterprise. The private investors now need not run after bureaucrats in various industries to seek clearance for setting up new units or to execute plans of expansion of existing capacity or undertaking the production of new products in the same industry. This has been welcomed by the industry captains.

2) **Reforms of the public sector:** This has been undertaken in a systematic manner and a number of steps have been taken.

   a) Overstaffing of public sector is being progressively reduced. In 1990-91, a total of 22.19 lakhs employees were working in public sector undertakings and their number has been brought down to 20.41 lakhs — a reduction of 1.78 lakhs. In other words, employees strength has been reduced by 8 per cent.

   b) To help the workers affected by NEP, the government set up the National Renewal Fund (NRF) to provide compensation for voluntary retirement. It was also decided that these workers will be provided training so that they can take up some other job. A review of the working of NRF reveals that during the two year period (1993-94 and 1994-95), Rs. 803 crores were paid as compensation against voluntary retirement, but the training and retraining of workers has been tolally neglected.

   c) The government referred 53 PSUs which were chronically sick to the BIFR upto March 1995. In case of 6 PSUs, revival schemes were recommended. The government is taking appropriate action. BIFR also decided that in the following cases, revival was not possible and these units be wound up. They are : National Bicycles Corporation of India Ltd., Elgin Mill Co. Ltd., and Tannery and Footwear Corporation Ltd. The cases of other units are pending under inquiry.

   d) Due to prevailing atmosphere of new economic reforms and the threat of closure in case of inefficiency continues, the public sector units have 'got a jolt and there is an effort lo improve the performance of PSUs. This is evidenced by the fact that during 1995-96, the gross profit as percentage of capital employed reached a record level of 16.1 per cent and net profits also shot up to 5.6 per cent. This is a very welcome developmenl.

   e) The government has undertaken disinvestment of PSUs to the extent of 5 to 20 per cent, During the period 1991-92 to 1996-97, a total of Rs. 12,455 crores was raised through this source. The entire amount was used to cover Central Government deficits. The PSUs which have been privatised are the most healthy units. Recently, the PSUs are finding few takers of their shares. This explains the sharp decline of disinvestment fund raised during 1996-97 to a low figure of Rs. 500 crores.

The main criticism against the government policy is that it has only undertaken deficit privatisation. Actually, the government should, therefore, decide that the resources raised through disinvestment of PSUs will be used to strengthen either weak PSUs or modernise PSUs to improve their technology.

3) **Programme of privatisation:** This has not yielded any tangible results. Whenever the government indicated its intention to privatise PSUs, there was strong resistance by trade unions. The government tried in case of banks and LIC, but had to retreat. Even the bureaucrats who consider PSUs as their 'colonies' have been silently working against privatisation. Since the prevailing political instability prevents the government to pursue the policy of privatisation with vigour, it considers it more advisable to reform the public sector.

4) **Globalbation of the economy:** To strengthen the globalisation of the economy, the government has undertaken a number of measures. These are:

i) *Reduction of import duties:* The government has undertaken a considerable reduction of import duties. For instance, the maximum rate of import duty has been reduced from 150% in 1991-92 to 50% in 1995-96. Similarly, custom duties on the import of capital goods were reduced from 80% in 1991 to 25% in 1995. Tariffs on import of raw materials and manufactured goods have also been effectively reduced. Besides these, the government has also removed quantitative restrictions on imports and exports. It has also attempted an adjustment of exchange rate to remove over-valuation of the rupee. This has helped to step up exports. On the 8th of February 1997, the Commerce Ministry removed restrictions on 162 items for imports. Out of them, 69 items were moved from Special Import Licence (SIL) to free imports. All these measures have been taken to facilitate the free flow of trade.

Table 16.1 : Growth of Exports and Imports during the post-reform period

	In Rs. Crores			In US $ million		
	Exports	**Imports**	**Trade Balance**	**Exports**	**Imports**	**Trade Balance**
1991-92	44,042	47,851	-3,809	17,866	19,411	-1,545
1992-93	53,688	63,375	-9,687	18,537	21,882	-3,345
1993-94	69,751	73,101	-3,350	22,238	23,306	-1,068
1994-95	82,674	89,971	-7,297	26,331	28,654	-2,323
1995-96	106,353	122,678	-16,325	31,797	36,678	-4,881
1996-97(P)	117,525	136,844	-19,319	33,106	38,548	-5,442

(P) stands **for** provisional
Source: Reserve Bank **of India** Bulletin, **July** 1997.

As a result of NEP, there has been a rapid growth of exports (see table 16.1). As per data given by the Director General of Commercial Intelligence & Statistics (DGCIS), exports have increased from US $ 17,866 million in 1991-92 to US $ 33,106 million in 1996-97 an increase of 85 per cent during the last 5 years. Simultaneously, imports have also shot up from US $ 19,411 million in 1991-92 to US $38,548 million in 1996-97 an increase of 83 per cent. The trade balance deficit which was of the order of US $1,545 million in 1991-92 has gone up to US $ 5,442 million in 1996-97. Obviously the benefit due to export growth has been more than neutralised due to a rapid rise of imports. This has imposed higher foreign exchange burden on the Iqdian economy.

It is, therefore essential that to reach a situation of favourable balance of trade, a cautious policy in opening the import window too widely be followed.

Table 16.2 : Exchange Rate of Rupee vis-a-vis US Dollar

	Rs. Per US $
1990-91	17.96
1991-92	24.47
1992-93	28.96
1993-94	31.37
1994-95	31.39
1995-96	33.45
1996-97	35.60

ii) *Fall in the external value of the rupee:* One of the objectives of the NEP was to stabilise the exchange rate of the Rupee vis-a-vis US Dollar. But as facts indicate clearly, the internal value of the rupee was 1$=Rs. 17.96 in 1990-91 (table 16.2). This has come down to 1$=Rs. 35.60 in 1996-97. Fall in the value of the rupee results in an increase in the burden of international debt. Secondly, it has an adverse effect on foreign investor's confidence in India. Both factors adversely affect the interests of the Indian economy,

iii) *NEP and India's foreign exchange reserves:* The advocates of globalisation claim that as a result of new economic policies, foreign exchange reserves which were barely US $ 2.236 billion in 1990-91 increased to US $ 20.81 billion in 1994-95, but due to a sharp deficit in the balance of payments on current account, these reserves came down to a low level of US $ 17.0 billion in 1995-96. These reserves again increased to US $ 22.37 billion during 1996-97 and were of the order of US $25.41 billion on July 4, 1997. However, it may be noted in no year, the balance of payments of current account was positive. It has, throughout, been negative. The critics maintain that the accumulation of foreign exchange reserves does not indicate the strength of the Indian economy, because they. are largely a consequence of loans and borrowings from international financial institutions. Partly, flow of funds for portfolio investment has also contributed to the sharp increase in foreign exchange reserves.

iv) *Foreign investment flows into India:* A Major contribution of the NEP is that it has facilitated the flow of foreign investment. Foreign investment inflows are of two types—i) foreign direct investment and ii) Portfolio investnlent.

Foreign direct investment helps to increase the production of goods and services and creation of infrastructure in the form of hydro-electric projects, telecommunications, construction of express highways, manufacturing units, etc. As against it, portfolio investment is financial investment in the form of equity, stocks, bonds and debentures undertaken by a foreign national or a foreign company in India. Portfolio investor compares the rates of return expected from the company in which he invests and the risk involved in such an investment, Whereas foreign direct investment leads directly to the building of productive assets of an economy, portfolio investment is of a financial nature and is purely concerned with its rate of return. The portfolio investment can be liquidated if the economic prospects are gloomy.

Table 16.3 : Foreign Investment Flows by Categories

US $ million

	Direct Investment	Portfolio Investment	Total
1991-92	150	8	158
1992-93	341	92	433
1993-94	586	3,649	4,235
1994-95	1,314	3,581	4,895
1995-96	2,133	2,214	4,347
Total (1991-96)	4,524 (32.2)	9,544 (67.8)	14,068 (100.0)

Source: Government of India, Economic Survey (1996-97)

Table 16.3 shows that during 1991-92 and 1995-96 — a period of 5 years, total foreign investment of the order of US $ 14,068 million was made, out of which foreign direct investment was barely of the order of US $ 4,524 million (32.2% of total) and portfolio investment was of the order of US $ 9,544 million (67.8% of total). In other words, foreign direct investment was barely one-third of the total investment. Critics believe that the share of foreign direct investment should increase since portfolio investment is of a speculative nature and is hot money which can lead to flight of capital during a period of political uncerlainty.

The data regarding approvals of direct foreign investment and actual inflows reveals that whereas during 1991-96, approvals aggregated to US $ 29.61 billion, actual flows were barely 5.69 billion, i.e., 19% of total approvals (Table 16.4).

Table 16.4 : Direct Foreign Investment: Actual inflows Vs Approvals

	Approvals	Actual
1991	325	155
1992	1,781	233
1993	3,559	574
1994	4,332	959
1995	11,245	2,100
1996*	8,367	1,670
Total (1991-96)	29,609	5,691

* Upto September 1996.

Source: Government of India, Economic **Survey** (1996-97)

Thus, the actual inflow of direct foreign investment during the last 6 years (1991-96) is only one-fifth of the total approvals. Unless the lag between actual inflows and approvals is narrowed down, it would be a folly to assume that foreign direct investment is helping in a big way to improve our economy.

16.5 AN ASSESSMENT OF NEW ECONOMIC POLICY

The NEP initiated with vigonr has brought several benefits, but it has not succeeded on several counts. It would be of interest to make an assessment of the policy.

Firstly, as a result of the new economic policy, gradually the growth of the economy which had slumped to a low level of 0.8 percent of GDP in 1991-92 has slowly recovered and during the last three years (1994-95 to 1996-97), it has averaged 7 percent of GDP which is a record achievement.

Secondly, NEP. by throwing the challenge of privatisation to the public sector undertakings (PSUs) has shaken them out of their slumber and this fear has instilled a vigorous effort to improve the performance of PSUs. In 1995-96, Central Government PSUs have shown a gross rate of return on capital employed at a record level of 16.1 per cent.

Thirdly, NEP has been able to arrest the inflationary trend of wholesale prices. The index of wholesale prices which rose by 13.7 per cent during 1991-92 (at 1981-82 prices) declined to 4.4 per cent during 1995-96 and 7.6 per cent in 1996-97. This is a healthy development.

Fourthly, the index of industrial production has also shown an overall growth rate from 0.6 percent in 1991-92 to 11.8 percent in 1995-96, though there is a decline to 6.6 percent in 1996-97,

Fifthly, growth of exports which was on a low order of 3.8 percent (measured in US $) in 1992-93 improved to 20.8 percent in 1995-96, but this has again slowed down to 4.1 percent in 1996-97. Similarly, growth of imports picked up from 12.7 percent in 1992-93 to 28.6 per cent in 1995-96 hut has again declined to 5.1 percent during 1996-97.

Lastly, foreign exchange reserves which had slumped to a low level of US $ 2.24 billion in 1990-91 have increased to a level of US $ 25.4 billion as on July 4, 1997. This has salvaged the Indian economy and its creditbility in the international market has improved.

NEP encompassing liberalisation, privatisation, globalisation and reform of the public sector has been concentrating on short-term objectives such as controlling the worsening situation of balance of payments, building up foreign exchange reserves, reducing fiscal deficit and controlling inflation etc. But the NEP has not been able to pay adequate attention to long-term gods of reducing poverty, achievement of full-employment, self-

reliance and reduction in inequalities of income and provision of equality of opportunity and social justice. Even in some of the short-term objectives like control of inflation and privatisation, it has succeeded only partially.

Major areas of concern towards which the NEP should re-orient itself are :

i) Its scope has been narrow. It has mainly concentrated on the large corporate sector. As a Consequence, there is a virtual neglect of small scale sector and agriculture which are the main sources of employment. It is, therefore, necessary that to improve the over-all economic growth and make it more sustainable from a long-term point of view, small scale sector and agriculture should be strengthened.

ii) In the sphere of privatisation, on account of resistance from trade unions, NEP has not been able to achieve any tangible results. It has, therefore, restricted itself to token privatisation of the most healthy public sector undertakings by the process of disinvestment. Moreover, the disinvestment proceeds have so far been used only to reduce the ,deficit of the Central Government. This is totally unjustifiable.

iii) While the NEP has been able to control the rate of increase in wholesale price index, it has failed to arrest the rise in the consumer price index of either industrial workers or agricultural labourers. Consumer price index has shown an annual average increase of about 10 per cent per annum during the period 1991-92 and 1996-97. This has welfare implications for the masses.

iv) NEP, has not been able to reduce the fiscal deficit on an enduring basis. It has failed to control non-plan expenditure, but has reduced plan expenditure to show a reduction in fiscal deficit. With the implementation of the Fifth Pay Commission report, non-plan expenditure is likely to shoot up much higher, but the chances of raising revenue through voluntary disclosure income scheme do not seem to be very bright. In other words, whereas it has given ample tax concessians to the more affluent sections hy reducing the maximum rate of taxation to 30 per cent, it has failed to persuade the tax evaders to disclose incomes.

v) While the NEP has depended more on the foreign private sector to create infrastructure, it has failed in this respect. For instance, foreign firms have not added even a single kilowatt of power during the last five years. As against the capacity addition target of 30,538 MW during the Eighth Plan, the actual achievement was barely 16,243 MW. which was 46 per cent short of the target.

To sum up, there is a need to re-orient NEP with a view to making it more broad-based so as to include agriculture and small scale industries. Excessive dependence on foreign investment is not the correct approach. The Indian private sector and the public sector should be given parity of treatment so that they can also contribute in building infrastructure in power, telecommunications and roads, etc. Recognising this, the then Prime Minister I.K. Gurjal while addressing the Conference organised by the Confederation of Indian Industry (CII) on August 16, 1997 stated: "The days of 19th century capitalism where any outsider can come and overwhelm you are over. Outsiders are welcome. But they will not be allowed to drown us and take over Indian companies. They will be allowed to invest in sectors where we need them." Moreover, "Indian trade and industry will get all the benefits of paternity, and il will not be allowed to face unfair competition."

Check Your Progress C

1. Give five major achievements of the NEP.

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2. List five major areas of weakness of NEP.

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3. 'State whether the following statements are True or False.

   i) The programme of privatisation has not yielded any tangible results,

   ii) The benefit due to export growth has been more than neutralised due to a rapid rise in imports.

   iii) In 1994-95 the internal value of the rupee per US dollar was 31.37.

   iv) As a result of the NEP, the index of industrial production has shown an over all growth from 0.6 per cent in 1991-92 to 11.8 per cent in 1995-96.

   v) The NEP has been concentrating on long-term objectives.

16.6 LET US SUM UP

The policies of public sector expansion and a system of licensing and controls which was developed during the first three decades of developnlent resulted in inhibiting investment by private sector. It also crealed an inefficient public sector which incurred losses year after year. Foreign investment also got discouraged due to excessive bureaucratisation, and a system of licensing and controls.

Four kinds of changes were envisaged in the NEP: i) liberalisation, ii) reform of the public sector, iii) privatisation, and iv) globalisation.

Liberalisation has helped the expansion of private sector to enlarge capacity, enter new areas and take up production of new products. Reform of the public sector has helped to shed the extra load of workers by a policy of retrenchment/voluntary retirement scheme. Chronically sick PSUs have been would up. Revival packages were undertaken in some cases. PSUs have improved their performance and in 1995-96, they have shown a record gross rate of return of 16 per cent on capital employed. Disinvestment of the most healthy PSUs was undertaken by the government to finance budget deficits.

Programmes of privatisation have not yielded tangible results due to slrong resistance by trade unions and leftist political parties. Bureaucracy has also been tacitly opposing privatisation. Privatisation of individual PSUs is not taking place, but the process of privatisation bf the economy in a broader sense of encouraging private sector investment is taking place.

NEP has been concentrating on short-term goals like improving balance of payments position, building up foreign exchange reserves, controlling inflation and reducing fiscal deficit. Major long-term objectives of reducing unemployment, poverty and providing social and economic justice ignored,

There is a need to go in for selective globalisation by taking reasonably protective measures for Indian industry so that foreign firms, after entry in the joint sector do not swallow Indian firms.

16.7 KEY WORDS

Deficit Privatisation: When the government disinvests its shares, lo the extent of 5% to 10% to meet the deficit in the budget, it is referred to as deficit privatisation.

Foreign Direct Investment: The form of investment that helps to increase Lhe production of goods and services, thereby increasing the productive capacity of the economy.

Globalisation: It refers to the process of opening up of the economy to the rest of the world so that a free flow of goods and services, technology and investment takes place.

Liberalisation: It implies a process of removing unnecessary shackles on the freedom of the private sector. The process involves the removal of unnecessary licensing, controls and regulation which have led lo bureaucratization and corruption.

Monopolies And Restrictive Trade l'ractices (MRTP) Commission: A Commission set up to screen applications for fresh investment and reject the application of those business houses whose assets were above the limit prescribed under the MRTP Act (1970) as amended from time to lime.

National Renewal Fund (NRF): It refers to the fund created by the government to provide a safety net for workers seeking voluntary retirement or those losing their jobs on account of privatisation.

Portfolio Investment: Financial investment in the form of equity, stocks, bonds and debentures undertaken by a foreign national or foreign company in India.

Privatisation: The process in which the ownership of a public sector unit is transferred to the private seclor.

Token Privatisation: When the government sells its shares by a very small percentage of 5% to 10% to raise resources, it is referred to as token privatisation.

White Goods: A term used to describe costly gadgets used by households, such as, refrigerators, washing machines, air-condilioners, micro-wave ovens, motor cars etc.

16.8 ANSWERS TO CHECK YOUR PROGRESS

B. i) strategic ii) sick iii) ownership iv) integrate v) free trade flows, free capital flows, . free technology flows.

C. 3. i) True, ii) True, iii) False, iv) True, v) False

16.9 TERMINAL QUESTIONS

1. Discuss the factors which acted as shackles on Indian economic development as a consequence of the policies followed during the first three decades.
2. What are the major elements of New Economic Policy? Explain in detail the measures taken with respect of each major element of NEP.
3. Discuss the narrow and broad concept of privatisation. What are the various forms of privatisation attempted in India? Have they yielded tangible results?
4. Discuss the various components of globalisation.
5. Give the major achievements of the Indian economy as a consequence of privatisation, liberalisation and globalisation. What lessons can be drawn from the experience of the last six years (1991 to 1997)?
6. Make a critical assessment of the New Econoinic Policy keeping in view both the short-term and long-term objectives of development.

Note: These questions will help you lo understand the Unit better. Try to write answers for them, but do not send your answers to the University. These are for your practice only.

SOME USEFUL BOOKS

Francis Cherunilam., *Business Environment,* Himalaya Publishing House, Mumbai.

George Steiner., *Business and Society,* Macmillan, New York.

Indira Gandhi National Open Univeristy, Course Materials — *MS-3: Economic and Social Environment.*

Tandon, B.B. & Tandon, K.K., *Indian Economy,* Tata Mc Graw Hill, New Delhi.